No. 99-387-CFX Title: Thomas E. Raleigh, Chapter 7 Trustee for Estate of William J. Stoecker, Petitioner
v.
Illinois Department of Revenue

Docketed:
September 1, 1999 Court: United States Court of Appeals for the Seventh Circuit

Entry	Date	Proceedings and Orders
	Aug 31 1999	Petition for writ of certiorari filed. (Response due November 16, 1999)
	Sep 27 1999	Waiver of right of respondent Illinois Department of Revenue to respond filed.
	Sep 29 1999	DISTRIBUTED. October 15, 1999
	Oct 1 1999	Response requested. (Due November 2, 1999 - NONE RECEIVED)
	Oct 1 1999	Brief amici curiae of New Mexico, et al. filed.
	Oct 8 1999	Order extending time to file response to petition until November 16, 1999.
	Nov 15 1999	Brief of respondent Illinois Department of Revenue in opposition filed.
	Dec 1 1999	REDISTRIBUTED. January 7, 2000
	Jan 7 2000	Petition GRANTED. The brief of petitioner is to be filed with the Clerk and served upon opposing counsel on or before 3 p.m., Tuesday, February 22, 2000. The brief of respondent is to be filed with the Clerk and served upon opposing counselon or before 3 p.m., Thursday, March 23, 2000. A reply brief, if any, is to be filed with the Clerk and servedupon opposing counsel on or before 3 p.m., Monday, April 10, 2000. Rule 29.2 does not apply. SET FOR ARGUMENT April 17, 2000. **********
	Jan 7 2000	Motions to file briefs as amicus curiae and any motions relating to oral argument must be filed with the Clerk and served upon opposing on or before 3 p.m., Friday, March 24, 2000. Rule 29.2 does not apply.
	Jan 21 2000	Motion of the parties to dispense with printing the joint appendix filed.
	Feb 22 2000	Motion of the parties to dispense with printing the joint appendix GRANTED.
	Feb 22 2000	Brief of petitioner Thomas Raleigh, Chapter 7 Trustee filed.
	Mar 1 2000	Record filed.
	Mar 10 2000	CIRCULATED.
	Mar 22 2000	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
	Mar 22 2000	Brief of respondent Illinois Department of Revenue filed.
	Mar 22 2000	Brief amicus curiae of Pension Benefit Guaranty Corporation filed.
	Mar 22 2000	Brief amicus curiae of United States filed.
	Mar 23 2000	Brief amici curiae of New Mexico, et al. filed.
	Mar 23 2000	Brief amici curiae of Council of State Governments, et al. filed.
	Mar 30 2000	Motion of the Solicitor General for leave to participate

No. 99-387-CFX

Entry	Date	Proceedings and Orders
		in oral argument as amicus curaie and for divided argument DISTRIBUTED.
	Apr 3 2000	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
	Apr 7 2000	Reply brief of petitioner Thomas Raleigh, Chapter 7 Trustee filed.
	Apr 17 2000	ARGUED.

Supreme Court, U.S.
FILED
99 387 AUG 31 1999
OFFICE OF THE CLERK

No. _____

In The

Supreme Court of the United States

THOMAS E. RALEIGH,
Chapter 7 Trustee for
Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Should tax claims in bankruptcy be given the advantage of placing the burden of proof on an objecting trustee, in contrast to the rule applicable to the claims of other creditors?

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PETITION FOR A WRIT OF CERTIORARI

Thomas E. Raleigh, Chapter 7 Trustee for the Estate of William J. Stoecker, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on June 2, 1999.

OPINIONS BELOW

The opinion of the court of appeals is reported at 179 F.3d 546 and is reproduced in Appendix A. The memorandum opinion and order of the district court is unreported and is reproduced in Appendix B. The memorandum opinion of the bankruptcy court is reported at 202 B.R. 429 and is reproduced in Appendix C. Earlier related opinions of the district court and the bankruptcy court are reported at 179 B.R. 532 and 151 B.R. 989 and are reproduced in Appendices D and E, respectively.

JURISDICTION

The judgment of the court of appeals was entered on June 2, 1999. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND RULES INVOLVED

United States Code, Title 11:

§ 501 Filing of proofs of claims or interests.

(a) A creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest.

§ 502 Allowance of claims or interests.

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

Federal Rules of Bankruptcy Procedure:

Rule 3001 Proof of Claim.

(f) Evidentiary Effect. A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim.

STATEMENT OF THE CASE

Petitioner Thomas E. Raleigh is the chapter 7 trustee ("Trustee") for the bankruptcy estate of William J. Stoecker. This case involves the Trustee's objection to the allowance of a claim filed by the State of Illinois for penalties arising from the failure of a corporation of which Stoecker was an officer to pay a use tax. Jurisdiction in the district court was based on 28 U.S.C. § 1334.

Stoecker had been the president and sole director of an Illinois corporation known as Chandler Enterprises, Inc. ("Chandler"). In September, 1988, Chandler purchased a Falcon 50 airplane from an out-of-state seller. Chandler obtained a legal opinion from a member of the Chicago law firm of Lord, Bissell & Brook that Chandler's purchase of the airplane was exempt from Illinois sales and use tax.

The Illinois use tax is essentially a sales tax imposed on Illinois residents who buy personal property from out-of-state sellers. If, as is often the case, the out-of-state seller does not collect and remit the tax, the resident purchaser must file a return and pay the tax directly. Chandler filed no return, but in due course, the Illinois Department of Revenue (the "Department") made a determination that the tax was owed and issued a Notice of Tax Liability against Chandler. After Chandler failed to respond to the Notice of Tax Liability, the Department ascertained from the Illinois Secretary of State that Stoecker was an officer and director of Chandler. Based on that information, the Department issued a Notice of Penalty Liability to Stoecker informing him that he was liable for the full amount of the tax owed by Chandler, including interest and penalties. Under Illinois law, any corporate officer "who has the control, supervision or responsibility of filing returns and making payment of the amount of any [use] tax . . . who wilfully fails to file the return or make the payment . . . shall be personally liable for a penalty equal to the total amount of tax unpaid by the [corporation]. . . . " 35 ILCS 735/3-7(a). The Department's only evidence that Stoecker was a responsible officer who wilfully failed to pay the tax was the

records of the Illinois Secretary of State showing Stoecker's position as an officer and director of Chandler.

The Department filed a proof of claim in Stoecker's bankruptcy case asserting a priority claim in the amount of approximately $1,476,000, later reduced to $917,000. The basis for the Department's claim was the Notice of Penalty Liability issued to Stoecker as a "responsible officer" who "wilfully" failed to pay the use tax owed by Chandler.

Pursuant to 11 U.S.C. § 502 and Rule 3007 of the Federal Rules of Bankruptcy Procedure, the Trustee filed an objection to the Department's claim. The Trustee argued, *inter alia*, that Stoecker was not a "responsible officer" and did not wilfully fail to file a return and remit the tax within the meaning of Illinois law.

Between 1992 and 1997 there were extensive proceedings in the bankruptcy and district courts, resulting in a number of published opinions. *See* Appendices B through E. The bankruptcy court ruled that the proof of claim filed by the Department was *prima facie* evidence of the validity and amount of the claim pursuant to Federal Rule of Bankruptcy Procedure 3001(f).[1] If that *prima facie* case was rebutted by the Trustee, however, the burden of

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[1] The rule under Federal Rules of Bankruptcy Procedure 3001(f) is in accordance with prior practice under the Bankruptcy Act of 1898. *Accord, Gardner v. State of New Jersey*, 329 U.S. 565, 573 (1947) ("A proof of claim is, of course, *prima facie* evidence of its validity. . . . It is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide by the consequences of that procedure.").

persuasion remained with the Department – as with any other claimant in bankruptcy – to prove its claim by a preponderance of the evidence. The bankruptcy court ultimately held, *inter alia*, that the Trustee had successfully rebutted the *prima facie* validity of the Department's claim, and that the Department had failed to prove its claim by a preponderance of the evidence. Accordingly, the bankruptcy court upheld the Trustee's objection. *In re Stoecker*, 202 B.R. 429 (Bankr. N.D. Ill. 1996).

The district court concurred with the bankruptcy court's allocation of the burden of persuasion and, because the Department had no evidence beyond the records of the Secretary of State showing Stoecker as an officer and director of Chandler, held that the bankruptcy court's decision that the Department had failed to prove its claim was not clearly erroneous and therefore affirmed.

The court of appeals reversed on the ground that the burden of proof under non-bankruptcy law controlled in claim-objection proceedings in the bankruptcy court. Disagreeing with the lower courts, the court determined that because under Illinois state tax law the burden of persuasion is on the corporate officer to disprove responsible officer liability, it was the Trustee's burden to do so in the claim-objection proceeding. Finding that the evidence offered by the Trustee, while possibly sufficient to satisfy the burden of production, was not sufficient to sustain the Trustee's burden of persuasion, the court held that the Department's claim was valid.

REASONS FOR GRANTING THE WRIT

THERE IS A CONFLICT AMONG THE CIRCUITS AND THE ISSUE IS ONE OF WIDESPREAD IMPORTANCE IN THE ADMINISTRATION OF THE BANKRUPTCY LAWS.

The courts of appeals are split on the question of whether a taxing authority bears the ultimate burden of persuasion on its claim in a bankruptcy proceeding. The Fifth, Eighth, Ninth, Tenth and Federal Circuits have held that the taxing authority bears the burden of persuasion. *Matter of Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993); *In re Brown*, 82 F.3d 801, 804-05 (8th Cir. 1996); *In re Macfarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), *cert. denied*, 520 U.S. 1115 (1997); *In re Fullmer*, 962 F.2d 1463, 1466 (10th Cir. 1992); *Bronson v. United States*, 46 F.3d 1573, 1581-82 (Fed. Cir. 1995). The Seventh Circuit has now joined the Third and Fourth Circuits in holding that the burden of persuasion is not shifted to the taxing authority by the taxpayer's filing of a bankruptcy petition. *Resyn Corp. v. United States*, 851 F.2d 660, 663 (3d Cir. 1988); *In re Landbank Equity Corp.*, 973 F.2d 265, 270-71 (4th Cir. 1992).

The frequency with which the question presented in this case arises is suggested not only by the number of cases cited and discussed in the several opinions in this case but also by the sizable number of additional cases referred to in those cases and by the continuing conflicting decisions rendered by lower courts. *Compare In re Forte*, 234 B.R. 607, 617-18 (Bankr. E.D. N.Y. 1999) *with Barrows v. I.R.S.*, 231 B.R. 446, 449-52 (D. N.H. 1998). The Seventh Circuit's decision in this case is likely to generate additional controversy and conflicts in view of the sharp clash of viewpoints and analysis reflected in the several

opinions in this case. *Cf.* Jack F. Williams, *Final Report of the Tax Advisory Committee to the National Bankruptcy Review Commission*, at Section 3, ¶211 (Aug. 1997).[2] Moreover, none of the lengthy bankruptcy-related bills currently pending in Congress addresses the allocation of the burden of proof in tax claim objection proceedings. *See* Bankruptcy Reform Act of 1999, H.R. 833, 106th Cong., 1st Sess. (1999); Bankruptcy Reform Act of 1999, S. 625, 106th Cong., 1st Sess. (1999); Consumer Bankruptcy Reform Act of 1999, S. 945, 106th Cong., 1st Sess. (1999).

The question presented in this case arises in every case in which a debtor, a trustee, a creditor's committee or an individual creditor files an objection to a governmental tax claim. The overwhelming majority of the million plus bankruptcy cases filed each year involve claims for state, local or federal taxes. Thus, resolution of the question presented in this case is important to the administration of bankruptcy cases throughout the country.

As a general rule, the ultimate burden of proof on a claim against a debtor's estate rests with the claimant. *Matter of Carlson*, 126 F.3d 915, 921 (7th Cir. 1997). Accordingly, a number of courts have held that, regardless of the

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[2] The Tax Advisory Committee considered three proposals concerning allocation of the burden of proof: first, to impose the burden of proof existing under non-bankruptcy law; second, to subject taxing authorities to the same burdens of proof imposed on other creditors under the Bankruptcy Code and Rules; and third, to allow the bankruptcy court to place the burden of proof where appropriate when the objector is not the debtor, *e.g.*, the trustee or another creditor. By divided votes, the Advisory Committee endorsed the first and third proposals and rejected the second.

allocation of the burden of proof in tax litigation outside bankruptcy, a taxing authority, like any other creditor, bears the ultimate burden of proving its claim in a bankruptcy proceeding. *E.g., In re Macfarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), *cert. denied*, 520 U.S. 1115 (1997); *In re Brown*, 82 F.3d 801, 805 (8th Cir. 1996); *Matter of Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993); *In re Fullmer*, 962 F.2d 1463, 1466 (10th Cir. 1992). Other courts, including the Seventh Circuit in this case, have held that the burden of proof under non-bankruptcy law applies.

Courts embracing the latter view ignore or minimize the federal interests supporting a uniform allocation of the burden of proof in bankruptcy cases. Outside bankruptcy, the dispute is entirely between the taxpayer and the taxing authority. Thus, the rationale for placing the burden of proof on the taxpayer – that the taxpayer has greater knowledge of its financial affairs and access to its own records – is controlling. Once the taxpayer becomes a bankrupt debtor, however, the dispute is not between the taxing authority and the debtor, but between the taxing authority and the debtor's other creditors who compete for the assets in the debtor's estate. The debtor's creditors or creditors' committee or trustee have no greater access to the debtor's records than does the taxing authority, nor did they have any ability to influence the integrity or accuracy of the debtor's pre-petition record keeping. Moreover, because many tax claims are entitled to priority treatment under 11 U.S.C. §§ 507 and 726 and may be exempt from discharge under 11 U.S.C. § 523 (without the filing of a proof of claim), taxing authorities are already placed at a decided advantage over other

unsecured creditors. Thus, as other courts have recognized, the policy considerations underlying the general rule that a taxpayer bears the burden of persuasion no longer control when the taxpayer becomes a bankrupt debtor:

> The rule regarding the placing of the burden of proof on the taxpayer in tax cases generally presumably arises from the superior access which a taxpayer has to its own records and knowledge of its own affairs, relative to that of the IRS. . . . This policy evaporates if someone other than the taxpayer, *e.g.*, a trustee or another creditor, is pressing the objection. Also driving the allocation of the burden is the assumption that the taxpayer wishes to avoid paying taxes to serve its own economic self-interest. While the Debtor-taxpayer is the party challenging the instant assessment, it is doing so in its role as a debtor-in-possession, in which it is placed in the role of a fiduciary for all of the Debtor's creditors. Therefore, self-interest, while present, is muted somewhat from that of the ordinary taxpayer and involves the interests of third parties who are not parties to the immediate dispute.

In re Compass Marine Corp., 146 B.R. 138, 146 (Bankr. E.D. Pa. 1992). *See In re Arndt*, 201 B.R. 853, 858 (M.D. Fla. 1996) ("Granting a taxing authority . . . a presumption of correctness to their claim ignores the differences between a typical district court or tax court proceeding, where only one claim is at issue, and a bankruptcy proceeding, where many claims are subject to the court's determination."); *In re Brady*, 110 B.R. 16, 18 (Bankr. D. Nev. 1990) ("the estate is a party in interest and not just the taxpayer").

The Seventh Circuit, rejecting the argument for equal treatment of creditors, noted that the Bankruptcy Code reflects a conscious Congressional decision to give more favorable treatment to tax creditors in many instances. While taxing authorities are given favorable treatment under various sections of the Bankruptcy Code, they are not the only creditors so favored, yet they are the only creditors to benefit from not having the burden of persuasion on their underlying claims if the Seventh Circuit's view prevails. Among the priority claims identified in 11 U.S.C. § 507, seven classes of claimants enjoy higher priority than taxing authorities, but all these other priority claimants bear the ultimate burden of proof on their claims. Moreover, a taxing authority, like any other claimant seeking to exempt its claim from discharge under 11 U.S.C. § 523 (except a non-debtor former spouse seeking nondischargeability under § 523(a)(15)), bears the burden of proof as to all elements of nondischargeability. *Grogan v. Garner*, 498 U.S. 279, 287 (1991); *Matter of Crosswhite*, 148 F.3d 879, 884-86 (7th Cir. 1998); *In re Gamble*, 143 F.3d 223, 226 (5th Cir. 1998).

Nothing in the Bankruptcy Code evidences any Congressional intent to favor tax creditors with respect to the burden of proof in a claim objection proceeding. Because the Code does not make an exception for tax creditors to the burden applicable to all claimants in a claim objection proceeding, the bankruptcy and district courts correctly held in this case that the burden of persuasion lay with the Illinois Department of Revenue.

CONCLUSION

For the reasons stated, a writ of certiorari should issue to review the judgment of the Seventh Circuit.

Respectfully submitted,

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APPENDIX A

In the

United States Court of Appeals

for the Seventh Circuit

No. 98-3590

IN RE: WILLIAM STOECKER,

Debtor,

APPEAL OF: STATE OF ILLINOIS, Department of Revenue

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 97 C 414 – Wayne R. Andersen, *Judge.*

ARGUED APRIL 16, 1999 – DECIDED JUNE 2, 1999

Before POSNER, *Chief Judge,* and BAUER and ROVNER, *Circuit Judges.*

POSNER, *Chief Judge.* This bankruptcy appeal has a complicated procedural history that we shall ignore; the curious are referred to 151 B.R. 989 (Bankr. N.D. Ill. 1992); 179 B.R. 532 (N.D. Ill. 1994), and 202 B.R. 429 (Bankr. N.D. Ill. 1996). All that matters is that the bankruptcy court eventually disallowed Illinois's claim against the debtor's estate for some $900,000 in unpaid Illinois use tax (including interest), Ill. Rev. Stat. ch. 120, ¶ 439.12 (1989), which was owed on the purchase of a corporate aircraft. (The current statute, 35 ILCS 105/12, has a narrower

scope, but we shall cite to it because the provisions that we discuss are materially the same.) The district court affirmed the disallowance, precipitating this appeal by the state against the trustee in bankruptcy.

The plane had been bought by Chandler Enterprises, Inc., an Illinois company (now defunct) of which Stoecker was president. The state claims that Stoecker is liable for the tax as a "responsible officer" of Chandler. 35 ILCS 735/3-7. If this is right, the liability is a debt of the estate in bankruptcy.

Chandler had asked Jack Prewitt & Associates (JPA), an established buyer and seller of corporate jets, to find one for it. JPA located a suitable jet that was for sale by Bezwada Investments and agreed with Chandler to broker the purchase. But Chandler did not have the cash to pay the plane's full purchase price, which was in excess of $12 million, right away; so JPA turned to an affiliate, Prewitt Leasing, Inc. (PLI), which does airplane leasing and financing, for help with the sale. JPA bought the plane from Bezwada and transferred the title from itself to PLI. PLI then entered into an "Aircraft/Lease Purchase Agreement" with Chandler under which Chandler agreed to pay PLI $2.4 million immediately to be "applied to the final purchase price of the aircraft" and $10 million more (plus interest denominated "lease payments" on the $10 million) in 90 days if it decided to buy. Until the purchase option was exercised, title would remain in PLI. But during the 90-day option period, Chandler would have the full use of the plane and indeed could modify it as it saw fit. In June 1998, Chandler took delivery of the plane and transported it to Illinois and in September it exercised the option and PLI transferred

title to it. Thus the transaction was Bezwada-JPA-PLI-Chandler.

The Illinois use tax is a sales-tax substitute imposed on Illinois residents (which Chandler is conceded to be, or rather to have been, since it is now defunct) who buy from out-of-state sellers. If the seller doesn't pay the tax, the buyer must file a return and pay the tax and in the case of aircraft the return must be filed and the tax paid within 30 days after the aircraft enters the state. 35 ILCS 105/10. When no return is filed – and Chandler filed no return – the Illinois Department of Revenue determines the amount of tax due and issues a Notice of Tax Liability to the taxpayer. 35 ILCS 105/12, 120/4. Unless the taxpayer protests the notice within the time provided, it become [sic] a final assessment although it is still subject to judicial review in the Illinois circuit court. 35 ILCS 120/4, 12.

The taxpayer may not be the only one liable for a tax. Under Illinois law, any corporate officer "who has the control, supervision or responsibility of filing returns and making payment of the amount of any . . . tax . . . who willfully fails to file the return or make the payment . . . shall be personally liable for a penalty equal to the total amount of tax unpaid by the [corporation]." 35 ILCS 735/3-7. The Department determines the penalty, and its determination is "prima facie evidence of a penalty due." *Id.* It embodies this determination in a Notice of Penalty Liability which is sent to the officer. The procedures for challenging a Notice of Penalty Liability are similar to those for challenging a Notice of Tax Liability.

Chandler not only failed to file a use-tax return; it failed to register the plane with the Illinois Department of Aviation, as it was required to do. As a result, it took the Department of Revenue years to discover that Chandler owed use tax and by that time the company was defunct and Stoecker, its president, was in bankruptcy. The Department issued both a Notice of Tax Liability, futilely, against Chandler and a Notice of Penalty Liability against Stoecker.

There are two principal issues. The first, which the district court resolved in favor of the state, is whether Chandler owed use tax on the purchase of the plane. The second, which the court resolved in favor of the trustee, is whether, if Chandler did owe use tax, Stoecker is liable for that tax as a responsible officer. Since Chandler, now a ghost, cannot pay the tax, the court's second ruling spelled defeat for the state. The trustee defends the second ruling but attacks the first, arguing that no use tax was owed, in which event Stoecker had no responsible-officer liability regardless.

The district court thought itself and the bankruptcy court barred by the Tax Injunction Act, 28 U.S.C. § 1341, from reexamining Chandler's liability for use tax. The Act forbids federal courts to enjoin the assessment or collection of state taxes unless the taxpayer has no adequate remedy in the state courts. But Illinois is not trying to extract taxes from Chandler. It is trying to get a penalty in lieu of taxes from Stoecker's estate in bankruptcy. Its right to do so depends on whether Chandler owed use tax, and the district judge thought that a federal court cannot decide an issue of state tax law. That is incorrect. The Bankruptcy Code expressly authorizes bankruptcy

courts to decide tax issues, 11 U.S.C. § 505(a)(1), and although *state* taxes are not specified, the courts have interpreted the statute to cover them. *Adams v. Indiana*, 795 F.2d 27, 29 (7th Cir. 1986); *City Vending of Muskogee, Inc. v. Oklahoma Tax Comm'n*, 898 F.2d 122, 123-24 (10th Cir. 1990) (per curiam). The Act is anyway addressed only to injunctive remedies (or a declaratory judgment viewed as a preliminary to an injunction, *National Private Truck Council, Inc. v. Oklahoma Tax Comm'n*, 515 U.S. 582, 586 (1995)), and no one is seeking an injunction against the state's going after Chandler for the taxes that the state believes Chandler owes it. If federal courts could not determine the debtor's liability for state taxes – if they had to abstain pending a determination of that liability in state court – bankruptcy proceedings would be even more protracted than they are.

So we can consider the trustee's argument against that liability, and it is that PLI's sale of the aircraft to Chandler was an "isolated or occasional sale of tangible personal property at retail by a person who does not hold himself out as being engaged (or who does not habitually engage) in selling such tangible personal property at retail." 35 ILCS 105/2. An example would be a good bought at a garage sale; no use tax would be due. See 86 Ill. Admin. Code § 130.110(b) (1991); cf. *Knowledge Data Systems v. Utah State Tax Comm'n*, 865 P.2d 1387 (Utah App. 1993); *Nevada Tax Comm'n v. Bernhard*, 683 P.2d 21 (Nev. 1984) (per curiam).

PLI, unlike its affiliate JPA, was not engaged in the regular sale of aircraft at retail (or at wholesale, for that matter). In fact the sale to Chandler was apparently the first sale of an aircraft that PLI had made. The trustee

thus wants us to confine our attention to the transfer of title from PLI to Chandler. But that would be myopic. PLI is the financing arm of JPA, which is a retailer of aircraft. JPA found the plane for Chandler, took title to it from its previous owner, Bezwada, and brought PLI in to finance Chandler's purchase of it. Bezwada was (so far as we can tell) not a retailer. But JPA was and it acted as the intermediary in the sale to Chandler, at one point actually holding title, as in the ordinary retail sale where the retailer buys from a supplier and resells to a consumer. The fact that title passed from the retailer to its affiliate before coming to rest with Chandler did not make PLI the real seller. Otherwise transactions would be easily structured to avoid use tax by having an out-of-state retailer transfer title to its nonretailer affiliate for retransfer to the in-state purchaser. The "substance over form" doctrine of tax law, on which see *Gregory v. Helvering*, 293 U.S. 465 (1935); *Segal v. Commissioner*, 41 F.3d 1144, 1148 (7th Cir. 1994); *Yosha v. Commissioner*, 861 F.2d 494 (7th Cir. 1988); *ACM Partnership v. Commissioner*, 157 F.3d 231, 246-47 (3d Cir. 1998), would presumably allow the state to defeat the bankruptcy trustee's attempt to invoke the "isolated or occasional sale" exemption by recharacterizing the transaction as a sale by JPA to Chandler. Cf. *Continental Illinois Leasing Corp. v. Department of Revenue*, 439 N.E.2d 118 (Ill. App. 1982).

But this analysis is incomplete, because there is another and equally good way of playing "substance over form" in this case, and that is to treat the "real" sale as Bezwada to Chandler, with JPA and PLI holding title merely as security for financing the sale. See UCC §§ 1-201(37), 9-102, 810 ILCS 5/1-201(37), 5/9-102; *Orix*

Credit Alliance, Inc. v. Pappas, 946 F.2d 1258 (7th Cir. 1991); *Tilghman Hardware, Inc. v. Larrimore*, 628 A.2d 215 (Md. 1993). This particular application of the "substance over form" doctrine, however, is nixed by Illinois law, which expressly treats a transfer of title to a retailer as a sale even if the purpose is merely to grant a security interest. 86 Ill. Admin. Code § 130.1060(a); Illinois Dept. of Revenue Private Letter No. 92-0113, 1992 WL 154376 (Feb. 27, 1992). JPA took title; JPA is a retailer; therefore use tax was due on the subsequent transfer of title by JPA to Chandler.

So Chandler was liable for the tax and the next question is whether Mr. Stoecker was liable too under the "responsible officer" rule. The record contains no evidence about the structure, scale, or operations of Chandler – even about what business it was engaged in – except that we do know that it had an officer named Pluhar who acted as the company's financial officer. There is no evidence concerning Stoecker's role in the filing of Chandler's tax returns or the payment of any taxes due, and so no proof either that he was responsible for these corporate functions or that he willfully evaded the payment of the use tax. But just as under the corresponding federal law of responsible-officer liability for unpaid taxes, 26 U.S.C. § 6672; *United States v. Running*, 7 F.3d 1293, 1297 (7th Cir. 1993); *United States v. McCombs*, 30 F.3d 310, 318 (2d Cir. 1994), Illinois shifts the burden of proof – both production and persuasion – to the officer once a Notice of Penalty Liability is issued, *Branson v. Department of Revenue*, 659 N.E.2d 961, 968 (Ill. 1995); and the trustee has not carried it. He may have satisfied his burden of production by identifying Pluhar as Chandler's

corporate financial officer, but he has not satisfied the burden of persuasion. Stoecker was the president and as far as we know he and Pluhar were the only officers and both deeply involved in the tax affairs of their corporation.

It is true that, just as under the corresponding federal law, *Wright v. United States*, 809 F.2d 425, 427 (7th Cir. 1987), the failure to pay must be willful, implying at least gross negligence. *Branson v. Department of Revenue, supra*, 659 F.2d [sic: N.E.2d] at 965. Chandler had an opinion letter from a reputable lawyer that no tax was due because JPA really had just a security interest; and reliance on a reputable lawyer's opinion letter can negate willfulness, *Marrin v. Commissioner*, 147 F.3d 147, 152 (2d Cir. 1998); cf. *Hall v. Aqua Queen Mfg., Inc.*, 93 F.3d 1548, 1555 (Fed. Cir. 1996); *Westvaco Corp. v. International Paper Co.*, 991 F.2d 735, 743-44 (Fed. Cir. 1993), though it's not an automatic safe harbor. *Marrin v. Commissioner, supra*, 147 F.3d at 152-53; *O'Connor v. United States*, 956 F.2d 48, 52 n. * (4th Cir. 1992); *Smith v. United States*, 894 F.2d 1549, 1554 (11th Cir. 1990). But no evidence was presented that Stoecker ever saw the letter, let alone that he relied on it. There is no other evidence bearing on the issue of willfulness.

So the burden of proof is critical, and the trustee argues that whatever the rule under state law, the burden is on the state when the issue of responsible-officer liability is adjudicated in a bankruptcy proceeding. This shift is necessary, he contends, to promote "equality" among creditors in bankruptcy. Bankruptcy is an equitable procedure, and "equality is equity" (and vice versa),

Cunningham v. Brown, 265 U.S. 1, 13 (1924); *Scott v. Armstrong*, 146 U.S. 499, 511 (1892); *United States v. Real Property*, 89 F.3d 551, 554 (9th Cir. 1996); *Downriver Community Federal Credit Union v. Penn Square Bank*, 879 F.2d 754, 761 (10th Cir. 1989); *White v. Carolina Paperboard Corp.*, 564 F.2d 1073, 1087 (4th Cir. 1977), as numerous bankruptcy cases intone. E.g., *In re Elcona Homes Corp.*, 863 F.2d 483, 484 (7th Cir. 1988); *In re Joliet-Will County Community Action Agency*, 847 F.2d 430, 434 (7th Cir. 1988). These truisms have a particular appeal for those bankruptcy judges who would like to administer the bankruptcy laws in accordance with their personal notions of fairness. But it is now well settled that although the origins, procedures, and many of the remedies of bankruptcy are indeed equitable, a bankruptcy judge has no authority to cut down the entitlements that creditors seek to enforce in bankruptcy, except (see, e.g., *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983)) as provided by the Bankruptcy Code itself. *United States v. Noland*, 517 U.S. 535, 543 (1996); *Butner v. United States*, 440 U.S. 48, 55-56 (1979); *In re Carlson*, 126 F.3d 915, 920 (7th Cir. 1997); *In re FBN Food Services, Inc.*, 82 F.3d 1387, 1396 (7th Cir. 1996); *In re Lapiana*, 909 F.2d 221, 223 (7th Cir. 1990); *In re Landbank Equity Corp.*, 973 F.2d 265, 271 (4th Cir. 1992).

Bankruptcy is not a "free-for-all equity balancing act." *In re Lapiana, supra*, 909 F.2d at 224. It is a forum in which creditors prove the entitlements that state or federal law confers on them, and these entitlements are then enforced consistently with the provisions of the Code governing preferences, priority, and other issues that arise in the marshaling and collection of debts from a bankrupt debtor, none of which affects a state's tax claim.

An equity free-for-all would engender confusion and uncertainty and increase the strategic incentives to petition for bankruptcy either of debtors, if the bankruptcy court curtailed entitlements, or of creditors, if it expanded them. The closest to the power here asserted of a free-wheeling equitable discretion to cut down entitlements when they are sought to be enforced in a bankruptcy proceeding is the power of equitable subordination. 11 U.S.C. § 510. But it must be exercised case by case and not over a whole class of claims. *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213, 228-29 (1996); *United States v. Noland, supra*, 517 U.S. at 543; cf. *In re Envirodyne Industries, Inc.*, 79 F.3d 579, 581 (7th Cir. 1996).

Burden of proof is rightly classified as a part of the creditor's entitlement, implying that it is not shifted in bankruptcy. *In re Landbank Equity Corp., supra*, 973 F.2d at 270, so holds, though *In re Macfarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), is to the contrary. We acknowledged the division of authority in *In re Carlson, supra*, 126 F.3d at 921, without having to choose. Today we choose, and we choose *Landbank*. It is supported by the general pattern of American tax law, in which "payment precedes defense, and the burden of proof, normally on the claimant, is shifted to the taxpayer," *Bull v. United States*, 295 U.S. 247, 260 (1935), and by the countless cases which hold that burden of proof is "substantive" for purposes of the Erie doctrine, e.g., *Director v. Greenwich Collieries*, 512 U.S. 267, 271 (1994); *American Dredging Co. v. Miller*, 510 U.S. 443, 454 (1994); *Dick v. New York Life Ins. Co.*, 359 U.S. 437, 446 (1959); *Koppers Co. v. Aetna Casualty & Surety Co.*, 98 F.3d 1440, 1446 (3d Cir. 1996), in recognition of the critical

importance of burden of proof to a person's rights. Illinois has given its taxing authorities an entitlement to collect a penalty tax pursuant to a Notice of Penalty Liability that is defeasible only if the taxpayer can persuade the adjudicator that the tax is not due. That is different from an entitlement to collect the taxes listed in the notice upon proof by the state that the tax is due. On the latter view, the Notice of Penalty Liability really is just a notice, conferring no rights, adding nothing to the Notice of Tax Liability; on the former view, which seems to us the sound view, the Notice of Penalty Liability creates a defeasible right.

Congress can alter entitlements in bankruptcy, and sometimes does so, but there is no indication that it meant to shift the burden of proof from taxpayer to tax collector. Rather the contrary. The Code itself grants a favored position to claims of unpaid taxes, 11 U.S.C. §§ 507(a)(8), 523(a)(1) (we're about to see another example); and the close attention that the drafters of the Code paid to issues of burden of proof, e.g., 11 U.S.C. §§ 362(g), 363(o), 364(d)(2), 547(g), 1129(d), makes their silence on the burden of proof in tax cases eloquent. The position for which the trustee contends has no more basis in the Code than in the law of Illinois, and it would create a new incentive to declare bankruptcy. We have enough bankruptcies.

The last string to the trustee's bow is the argument that the state's tax claim was untimely. Bankruptcy Rule 3002(c) requires, with immaterial exceptions, that a proof of claim be filed with the bankruptcy court within 90 days after the first date set for the meeting of creditors, which in this case would have been by June 26, 1990. See

also Bankr. R. 9006(b)(3). The state's claim was not filed until 18 months later and it was therefore untimely. But in a conflict between the Code and the rules, the Code controls, 28 U.S.C. § 2075; *In re Pacific Atlantic Trading Co.*, 33 F.3d 1064, 1066 (9th Cir. 1994), and it permits – without even a loss of priority – the filing of certain untimely claims (other than by the debtor, *In re Danielson*, 981 F.2d 296 (7th Cir. 1992)), including the state's tax claims in this case. See 11 U.S.C. §§ 507(a)(8)(E), 726(a)(1). This is crystal clear under the current version of section 726(a)(1), but was clear enough under the old version, e.g., *Cooper v. Internal Revenue*, 167 F.3d 857 (4th Cir. 1999), the one applicable to this suit, though some courts disagreed. See cases cited in *id.* at 859.

The exception for instances of inexcusable delay, in which the tardy claim may be equitably subordinated to timely claims, 11 U.S.C. § 726(a) (incorporating § 510), is not available to Stoecker. Chandler's failure to register the aircraft or file a tax return prevented the state from discovering Stoecker's liability until long after the bankruptcy proceeding was commenced, an express purpose of the requirement of registration being to make sure that "all applicable fees and taxes shall be paid." 620 ILCS 5/42.

We conclude that the state has a valid claim against Stoecker's estate and that the decision of the district court must therefore be reversed.

We wish in closing to commend counsel for both parties (Benjamin Goldgar for the state and Robert

Radasevich for the trustee) for their excellent briefs and argument.

REVERSED AND REMANDED.

A true Copy:

Teste:

/s/ _____
Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re WILLIAM J. STOECKER, Debtor	)	No. 97 C 414
STATE OF ILLINOIS, DEPARTMENT OF REVENUE, Appellant, v.	)	Judge Wayne R. Andersen
THOMAS E. RALEIGH as Trustee of the Estate of William J. Stoecker, Appellee.	)	

MEMORANDUM OPINION AND ORDER

This matter is before the Court on the appeal of the State of Illinois Department of Revenue (the "Department") from the United States Bankruptcy Court for the Northern District of Illinois. *In re Stoecker*, 202 B.R. 429 (Bankr. N.D. Ill. 1996) (Squires, Bank. J.). The Bankruptcy Court granted in part and denied in part the motion for summary judgment of Thomas E. Raleigh. Raleigh is the Chapter 7 trustee (the "Trustee") of the estate of William J. Stoecker (the "Debtor"). The Trustee's objection to the Department's proof-of-claim in the Debtor's estate was sustained in part by the Bankruptcy Court and the Department's claim was disallowed. For the following

reasons, we affirm the decision of the Bankruptcy Court granting in part the Trustee's motion for summary judgment. We disagree with the Bankruptcy Court's holding that Chandler Enterprises, Inc. ("Chandler"), a third party non-debtor, did not owe the assessed use tax in the first instance.

I. BACKGROUND

For a more complete rendition of the facts of this case, see *In re Stoecker*, 202 B.R. 429. The Debtor was the president and sole director of Chandler. Chandler's financial officer was Lawrence Pluhar ("Pluhar"). In 1988, Chandler purchased an aircraft from Prewitt Leasing, Inc. ("Prewitt Leasing"). Neither Chandler nor Prewitt Leasing paid any Illinois use tax on Chandler's purchase of the aircraft. The Debtor asserts that his attorney advised him that no use tax was assessable or payable as a result of the purchase. Chandler was involuntarily dissolved by the Illinois Secretary of State on June 1, 1990.

The instant lawsuit began as an involuntary Chapter 11 bankruptcy petition against the Debtor. The petition was converted to a Chapter 7 bankruptcy petition on February 26, 1990. Pursuant to 11 U.S.C. § 341(a), the creditors held a meeting on March 28, 1990. Pursuant to Fed. R. Bankr. P. 3002(c), all proofs of creditor claims had to be filed on or before June 26, 1990, ninety days after the meeting, or the claims would be barred.

On September 7, 1990, the Department issued a Notice of Tax Liability against Chandler for the unpaid tax on the aircraft pursuant to 35 ILCS 105/12. After

Chandler failed to pay the assessed use tax, the Department issued a Notice of Penalty Liability against the Debtor pursuant to the Illinois Retailer's Occupation Tax Act, 35 ILCS 120/13.5. This statute provides that a "responsible officer" of a corporation may be held liable if the corporate taxpayer fails to pay taxes to the Department. The Debtor never paid the assessed use tax.

On January 21, 1992, approximately 18 months after the June 26, 1990 bar date, the Department filed a proof of claim against the Debtor's estate in the amount of $1,476,196.86 for the use tax allegedly owed by the Debtor because he was a responsible officer of Chandler. When the Trustee objected to the Department's late-filed proof of claim, the Bankruptcy Court sustained the objection and did not allow the Department's claim. The Department appealed the Bankruptcy Court's ruling.

In August 1994, this Court reversed the Bankruptcy Court's ruling and remanded the matter based on our finding that Fed. R. Bankr. P. 3002(c) does not act as an absolute bar date for creditor claims. *In re Stoecker*, 179 B.R. 532, 534 (N.D. Ill. 1994). We also directed the Bankruptcy Court to determine whether the Department's late-filed claim should be subordinated under the principles of equitable subordination. In a supplemental order, we reversed the Bankruptcy Court's decision to disallow the claim and remanded the matter to determine whether the Debtor is liable for the use tax as a responsible officer of Chandler. *Id.*

At the status hearing following the remand order, the trustee moved for summary judgment after the contested claim was set for trial. On April 29, 1996, the Bankruptcy

Court held a hearing pursuant to this Court's remand order. At that hearing, the parties submitted testimony and exhibits from the 1992 hearings, designated deposition transcripts and exhibits, and offered additional exhibits, but no witnesses testified.

On October 17, 1996, the Bankruptcy Court granted in part and denied in part the Trustee's motion. The Bankruptcy Court held that Chandler did not owe the use tax. The Bankruptcy Court also found that the Department failed to prove that the Debtor was a responsible officer of Chandler and that the Debtor had willfully failed to pay the alleged use tax. Finally, the Bankruptcy Court ruled that if the Department's claim had been allowed, the claim would not have been equitably subordinated under 11 U.S.C. § 510(c).

The Department filed the instant appeal on five grounds: (1) the Bankruptcy Court erroneously allocated the burden of proof; (2) the Bankruptcy Court had no jurisdiction to redetermine Chandler's tax liability; (3) the Bankruptcy Court erroneously found that Chandler was not liable for the tax; (4) the Bankruptcy Court erroneously held that the Debtor was not a "responsible officer" of Chandler; and (5) the Bankruptcy Court erroneously found that the Debtor's failure to pay the tax was not "willful."

The proof-of-claim action was a core proceeding before the Bankruptcy Court under 28 U.S.C. § 157(b)(2)(B). This Court has appellate jurisdiction pursuant to 28 U.S.C. § 158(a).

II. DISCUSSION

A. Standard Of Review

As a conclusion of law, a grant of summary judgment is reviewed de novo. The district court will affirm summary judgment "if there is no genuine issue as to any material fact and if the moving party is entitled to judgment as a matter of law." *McGinn v. Burlington N. R.R. Co.*, 102 F.3d 295, 298 (7th Cir. 1996). Summary judgment may be affirmed on any ground supported in the record, even if it was not relied upon by the court below. *Johnson v. Gudmundsson*, 35 F.3d 1104, 1115 (7th Cir. 1994).

The non-movant must set forth specific facts showing that there is a genuine issue as to any material fact. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986). The non-movant may not merely rest upon allegations in the pleadings or affidavits; rather he must go beyond the pleadings and support any contentions with proper documentary evidence. *Celotex Corp. v. Catrett*, 477 U.S. 317, 324 (1986). The language of Fed. R. Civ. P. 56(c) mandates the entry of summary judgment against a non-movant who fails to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. *Id.* at 322. Fed. R. Bankr. P. 7056 makes Fed. R. Civ. P. 56 applicable to adversary proceedings in bankruptcy.

The Bankruptcy Court made findings of fact and conclusions of law in accordance with Fed. R. Bankr. P. 7052 which incorporates Fed. R. Civ. P. 52. The district court must accept a Bankruptcy Court's findings of fact unless clearly erroneous. Fed. R. Bankr. P. 8013; *In re Merchants Grain, Inc.*, 93 F.3d 1347, 1351 (7th Cir. 1996),

cert. denied, 117 S. Ct. 948 (1997); *In re Tolona Pizza Prod. Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993). The Bankruptcy Court's conclusions of law must be examined *de novo*. *In re Merchants Grain, Inc.*, 93 F.3d at 1351; *In re Yonikus*, 996 F.2d 866, 868 (7th Cir. 1993).

B. Responsible Officer Liability

We must first rule on the Debtor's liability for Chandler's assessed Illinois use tax. The Debtor can be held liable for the unpaid taxes of a corporate taxpayer if he meets a two-prong test. First, he must be a "responsible officer" of the delinquent corporation. Second, his failure to pay the tax must have been "willful." 35 ILCS 120/13.5.

In our remand order, we directed the Bankruptcy Court to consider the Department's Notice of Penalty Liability against the Debtor as *prima facie* evidence that the Debtor was a responsible officer who willfully failed to pay the use tax assessed against Chandler. *In re Stoecker*, 179 B.R. at 544. Because most of the issues in responsible officer liability involve issues of fact, our review is conducted under a clearly erroneous standard. Fed. R. Bankr. P. 8013; *In re Merchants Grain, Inc.*, 93 F.3d at 1351.

1. Allocation of burden of proof and persuasion for a contested claim

The parties dispute which party has the ultimate burden of proof for a contested proof of creditor claim.

This question is an issue of law and is, thus, subject to *de novo* review. *Celotex*, 477 U.S. at 322.

The Department argues that, under Illinois law, the Trustee must disprove the elements of "responsible officer" liability. The Trustee contends that under both federal and Illinois law the ultimate burden of proof rests with the Department. The Bankruptcy Court held that the ultimate burden of proof rests with the Department. We agree with the Bankruptcy Court.

A creditor's proof of claim in a bankruptcy proceeding constitutes "*prima facie* evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f). If the Trustee overcomes the *prima facie* proof of claim, "the burden is again on the creditor to produce a preponderance of evidence establishing the validity of the claim." *Bank of Bellwood v. Stoecker (In re Stoecker)*, 143 B.R. 879, 883 (N.D. Ill. 1992), *aff'd in part, vacated in part on other grounds*, 5 F.3d 1022 (7th Cir. 1993). It is well established that, outside of the bankruptcy forum, the taxpayer bears the ultimate burden of proof for a contested claim. *United States v. General Dynamics Corp.*, 481 U.S. 239, 245 (1987); *In re MacFarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), *cert. denied sub. nom, California Franchise Tax Bd. v. MacFarlane*, 117 S. Ct. 1243 (1997). In bankruptcy proceedings, however, after a debtor has rebutted the *prima facie* validity of a claim, the ultimate burden rests with the creditor to prove the validity of the claim. *Bank of Bellwood*, 143 B.R. at 883; *In re Holm*, 931 F.2d 620, 623 (9th Cir. 1991). Thus, there is some tension when a taxing authority – itself not accustomed to bearing the burden of proof – is required to bear this burden in a bankruptcy proceeding.

Although this issue has not yet reached the Seventh Circuit, a majority of circuits reaching the issue have decided that once a Trustee has presented evidence to rebut the *prima facie* valid claim of a taxing authority, the taxing authority bears the ultimate burden of proving its claim. *See, e.g., In re Brown*, 82 F.3d 801, 804-805 (8th Cir. 1996); *In re MacFarlane*, 83 F.3d at 1045; *In re Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993); *In re Fullmer*, 962 F.2d 1463, 1466 (10th Cir. 1992). The Third and Fourth Circuits, however, have reached an opposite conclusion. *See, e.g., In re Landbank Equity Corp.*, 973 F.2d 265, 268-272 (4th Cir. 1992); *Resyn Corp. v. United States*, 851 F.2d 660, 663 (3rd Cir. 1988).

We agree with the Fifth, Eighth, Ninth, and Tenth Circuits. Indeed, we find the Ninth Circuit's reasoning in *In re MacFarlane* to be particularly persuasive since the claims of taxing authorities are already given priority over some other claimants under 11 U.S.C. § 507(a). The Ninth Circuit held that removing the burden of proof would grant the taxing authority a double benefit not authorized by statute. *In re MacFarlane*, 83 F.3d at 1045. In addition, "the policy goals of the bankruptcy system are put at risk when one class of creditors is given the benefit of a favorable presumption which has its origins outside of bankruptcy law." *In re Wilhelm*, 173 B.R. 398, 402 (Bankr. E.D. Wis. 1994) (deciding that the Internal Revenue Service bears the ultimate burden of proof in a bankruptcy proceeding).

Accordingly, in light of the specific order of claim priorities already listed in 11 U.S.C. § 507(a), we find that creditors should be treated equally with respect to the required burden of proof. The Department should not

gain a favorable presumption regarding the burden of proof, particularly when that presumption arises outside of bankruptcy law. *Accord In re MacFarlane*, 83 F.3d at 1045; *Wilhelm*, 173 B.R. at 402. The decision of the Bankruptcy Court, placing the ultimate burden of proof on the Department, is, therefore, affirmed.

2. The debtor was not a "responsible officer" of Chandler

In order to establish that the Debtor was a "responsible officer" under the Illinois Retailer's Occupation Tax Act, the Department must prove that the Debtor had "control, supervision, or responsibility for filing returns and making payment of the amount of tax herein imposed. . . . " 35 ILCS 120/13.5. In *United States Internal Revenue Serv. v. Charlton*, 2 F.3d 237, 240 (7th Cir. 1993), the Seventh Circuit addressed "responsible person" liability within the meaning of 26 U.S.C. § 6672 of the Internal Revenue Code, a provision somewhat analogous to § 13.5 of the Illinois Retailers Occupation Tax Act. There, the court found that several factors are relevant to the determination of whether a person is a responsible officer within the meaning of § 6672. *Id.* These factors include whether the person holds corporate office, has the authority to disburse funds on behalf of the company, and has the ability to hire and fire employees. *Id.* But, "[t]he true objective of this inquiry, and the sine qua non of liability under § 6672, is a determination that the taxpayer had the authority to allocate funds to pay the company's other debts in preference to its debt to the IRS." *Id.*

The Bankruptcy Court found that the Department "failed to introduce sufficient evidence to adequately prove that the Debtor had actual control, supervision, or responsibility for making payment of the tax allegedly owed by Chandler." *In re Stoecker*, 202 B.R. at 455. Furthermore, the Bankruptcy Court held that "there is no direct evidence . . . linking the Debtor to Chandler's day to day operations and the payment of its bills and taxes in the course of its business." *Id.* at 454. Finally, the Bankruptcy Court stated that "the limited evidence adduced showed that Pluhar, [Chandler's financial officer,] not the Debtor, was responsible for and in control of Chandler's finances." *Id.* at 455.

The Department contends that the delegation of disbursal responsibilities to Pluhar is insufficient, by itself, to relieve the Debtor of liability. Due to the lack of other evidence implicating the Debtor as a responsible officer, this argument is insufficient to hold that the Bankruptcy Court's finding is clearly erroneous. Indeed, we find the reasoning of the Bankruptcy Court to be persuasive and well supported by the evidence. Accordingly, we affirm the Bankruptcy Court's finding that the Debtor was not a "responsible officer" within the meaning of the Illinois Retailer's Occupation Tax Act.

3. The debtor's failure to pay the tax was not willful

Next, we examine the second prong of responsible officer liability, the requirement of "willfulness." 35 ILCS 120/13.5. The Illinois Supreme Court defined "willful failure to pay taxes" for the purpose of § 13.5 of the

Illinois Retailer's Occupation Tax Act as "intentional, knowing, and voluntary acts" or, alternatively, "[the] reckless disregard for obvious or known risks." *Branson v. Department of Revenue*, 168 Ill.2d 247, 255 (1995).

Chandler's outside counsel advised Chandler that the purchase of the aircraft did not create a use tax liability. The Bankruptcy Court found that Pluhar, as the officer responsible for Chandler's finances, reasonably relied on outside counsel's advice. Accordingly, the Bankruptcy Court found that the Debtor, through his agent Pluhar, relied on the opinion letter in deciding not to pay the tax. The Bankruptcy Court stated, " . . . the [D]ebtor's reliance on this opinion letter negates a finding that he acted consciously, voluntarily, intentionally, knowingly, or recklessly in his failure to pay the assessed tax." *In re Stoecker*, 202 B.R. at 457. Finally, the Bankruptcy Court held that "the totality of the evidence does not demonstrate that the Debtor's failure to pay the tax showed a 'gross negligence involving a known risk of violation' and was therefore willful." *Id.*

The Department maintains that the Bankruptcy Court's reasoning is flawed. Chandler's legal counsel issued the opinion letter on September 30, 1988. But, according to the Department, the sale of the aircraft took place on June 7, 1988. Thus, the Department argues that Chandler could not have relied on the opinion letter because the letter was not even issued until after the use tax was incurred and became payable. We disagree.

The date of sale for the aircraft is a factual finding to be reviewed by this Court under the clearly erroneous standard. *In re Merchant's Grain*, 93 F.3d at 1351. The

Bankruptcy Court held that the sale occurred on September 30, 1988, not on June 7, 1988 as the Department contends. The Bankruptcy Court found that "the Aircraft Purchase Agreement between Prewitt Leasing and Chandler is dated September 30, 1988." *In re Stoecker*, 202 B.R. at 460. Also, the Notice of Penalty Liability issued by the Department against Chandler asserts that the aircraft was purchased in September 1988. *Id.* Finally, "[the Department's] proof of claim [against the Debtor's estate] indicates a sale date of September 30, 1988." *Id.* In light of this evidence, we hold that the Bankruptcy Court's findings of fact regarding the date of sale are not clearly erroneous.

Based on its findings, the Bankruptcy Court also found that the Trustee successfully rebutted the presumption of willfulness that attached to the Notice of Penalty Liability. *In re Stoecker*, 202 B.R. at 463. The burden then shifted to the Department to prove the Debtor's willful failure to pay by a preponderance of the evidence. The Bankruptcy Court found that the Department did not met [sic] the burden of proof, and, therefore, that the Debtor did not willfully fail to pay the use tax. *Id.* at 462. For the same reasons given by the Bankruptcy Court, we affirm this finding as not in clear error.

Thus, we affirm the Bankruptcy Court's ruling that the Debtor was not a "responsible officer" who "willfully" failed to pay the tax assessed against Chandler. Accordingly, the Debtor is not liable for Chandler's outstanding use tax.

C. The Bankruptcy Court Cannot Redetermine The Tax Liability Of Chandler

We instructed the Bankruptcy Court to decide whether Chandler owed the assessed tax if it found that the Debtor was a responsible officer who willfully failed to pay the use tax assessed against Chandler. *In re Stoecker*, 179 B.R. at 541. In essence, we affirmed the Bankruptcy Court's jurisdiction to redetermine Chandler's tax liability based on the plain language of 11 U.S.C. § 505(a)(1), which states that the court is authorized to "determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." *Id.* (*citing In re Stoecker*, 151 B.R. 989, 990-999 (Bankr. N.D. Ill. 1992)). The Bankruptcy Court held that Chandler did not owe the use tax, and, because the Debtor's liability was contingent upon Chandler's liability, the Debtor did not owe the tax. *In re Stoecker*, 202 B.R. at 451. Despite our holding that the Debtor was not a responsible officer of Chandler, see *supra* § II.B, the resolution of the Bankruptcy Court's jurisdiction to redetermine Chandler's liability is important because it affects Chandler's ultimate liability for the use tax. We now hold that the Bankruptcy Court did not have jurisdiction to redetermine Chandler's tax liability.

The Department contends that the Tax Injunction Act, 28 U.S.C. § 1341, creates a jurisdictional bar preventing the Bankruptcy Court from redetermining the tax liability of Chandler, a third party non-debtor. The Bankruptcy

Court did not address this argument in its opinion and the Department now raises it for the first time in this appeal. The subject matter jurisdiction of the court may be challenged by a party or raised sua sponte by the court at any time during the proceedings. *Jackson v. Consolidated Rail Corp.*, 717 F.2d 1045, 1054 (7th Cir. 1983), *cert denied*, 465 U.S. 1007 (1984); Fed. R. Civ. P. 12(h)(3). Accordingly, we will now consider whether the Bankruptcy Court could properly redetermine the use tax assessed against Chandler.

The Tax Injunction Act provides that "[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy, and efficient remedy may be had in the courts of such state." 28 U.S.C. § 1341. The principal purpose of § 1341 was "to limit drastically federal court jurisdiction to interfere with so important a local concern as the collection of taxes." *Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 522 (1981). Indeed, Congress intended to divest "the federal courts of jurisdiction to interfere with state tax administration." *California v. Grace Brethren Church*, 457 U.S. 393, 410 (1982). Yet, these rulings seem in apparent conflict with 28 U.S.C. § 1334(b), which grants the district court jurisdiction over "all civil proceedings arising under Title 11, or arising in or *related to* cases under Title 11." 28 U.S.C. § 1334(b) (emphasis added). *See also* 28 U.S.C. § 157(a) (stating that "[e]ach district court may provide that any or all cases under Title 11 . . . or arising in or related to a case under Title 11 shall be referred to the bankruptcy judges for the district").

One recent court held that the Tax Injunction Act § 1341 does apply if a bankruptcy court is asked to enjoin

tax collection efforts against a third party. *McCrory Corp. v. State of Ohio*, 212 B.R. 229, 231 (S.D.N.Y. 1997). Moreover, with § 1334's "plain, speedy, and efficient" language, "[t]he obvious intention of Congress was to leave the door open for an injunction against local tax assessments if the assessed party did not have a reasonable opportunity to challenge the assessment in court." *Id.* at 232-233.

Though *McCrory Corp.* is not precedential authority, its reasoning is persuasive. Pursuant to the plain meaning of § 1341, the district court may not decide state tax issues if a plain, speedy, and efficient remedy is available in the state court. Accordingly, the dispositive jurisdictional issue is whether the Illinois use tax assessed against Chandler and, subsequently, the Debtor, could have been resolved in a plain, speedy, and efficient manner in the Illinois state court system.

The Department assessed a use tax against Chandler and sent two letters demanding payment on March 7, 1990 and June 7, 1990, respectively. Chandler did not respond to either letter. *In re Stoecker*, 202 B.R. at 442. On September 7, 1990, the Department issued a Notice of Tax Liability against Chandler for the use tax plus penalties and interest. Chandler had twenty days to protest the Notice of Tax Liability, but it did not respond. *Id.* With no timely protest filed, pursuant to Illinois law, the Notice of Tax Liability became a final tax assessment. On June 15, 1991, the Department issued a Notice of Penalty Liability against the Debtor as a purported "responsible officer" of Chandler.

At many stages prior to the final assessment, Chandler had reasonable opportunity to protest the use tax. We find that such remedy is precisely the "plain, speedy, and efficient" remedy contemplated by § 1341. Thus, while it is true that Chandler is not the debtor in bankruptcy, the assessed use tax is ultimately assessed against Chandler. The Debtor's derivative liability for this tax is contingent upon Chandler's liability. Therefore, it does not matter if the Debtor himself protested the use tax assessment because Chandler itself had an adequate opportunity to protest. The Debtor has been afforded the opportunity to protest the "responsible officer" determination, not Chandler's tax. *See supra*, § II.B.

Because the Department properly assessed the use tax against Chandler and afforded it the opportunity to protest the assessment, the Bankruptcy Court cannot redetermine the assessment under § 1341. Nonetheless, this rule may be relaxed if circumstances are so exceptional that enforcement of the assessed tax liability against an alleged "responsible officer" creates an inequitable situation for that individual. For example, if a corporation becomes insolvent or is dissolved and fails [sic] protest the assessment of a tax, a court could not normally redetermine the tax. If, however, the Department seeks to impose derivative-liability for the assessed tax on an officer of that corporation, before that officer can be liable as a "responsible officer," he must be afforded the opportunity [sic] protest the assessment. Accordingly, we reverse the Bankruptcy Court's holding that Chandler did not owe the assessed use tax.

D. The Bankruptcy Court Should Not Equitably Subordinate The Department's Proof Of Claim

The Department asserts that the issue of equitable subordination was not properly before the Bankruptcy Court because the Trustee never filed an adversary proceeding as required by Fed. R. Bankr. P. 7001(8). We disagree.

A party may waive its right to object to another party's failure to file an adversary proceeding. *See In re Pence*, 905 F.2d 1107, 1109 (7th Cir. 1990). The Bankruptcy Court noted the Department's argument but found that it had agreed to waive the formal requirement for an adversary proceeding. *In re Stoecker*, 202 B.R. at 463. For the same reasons given by the Bankruptcy Court, we do not find this procedural ruling to be in clear error. The Department has waived its right to object and, therefore, the issue of equitable subordination is properly before the Court.

The doctrine of equitable subordination is codified at 11 U.S.C. §510(c), which provides in relevant part:

> (c) Notwithstanding subsections (a) and (b) of this section, after notice and hearing, the court may –
>
> > (1) under principles of equitable subordination, subordinate for the purpose of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest. . . .

This statute recognizes the Bankruptcy Court's role as a court of equity and permits the court to disallow or

subordinate some claims in favor of other claims in order to produce just results. *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1248 (7th Cir. 1990).

A court must consider three elements in deciding whether to subordinate a claim: (1) whether the creditor engaged in misconduct; (2) whether that misconduct resulted in injury to the other creditors or an unfair advantage to the creditor engaged in misconduct; and (3) whether subordination of the debt would be inconsistent with other provisions of the Bankruptcy Code. *In re Vitreous Steel Prods. Co.*, 911 F.2d 1223, 1237 (7th Cir. 1990). While misconduct is not necessarily required to subordinate a claim, the inquiry must focus on the fairness to all creditors involved. *See Id.; In re McDonald Creek Dev. Co.*, No. 95 C 4988, 1996 WL 139396,*1 (N.D. Ill. March 20, 1996) (*citing In re Virtual Network*, 902 F.2d at 1246).

The Bankruptcy Court ruled that the Department's claim should not be equitably subordinated. *In re Stoecker*, 202 B.R. at 465. The decision of the Bankruptcy Court concerning equitable subordination is reviewed on the basis of clear error. *In re Osborne*, 42 B.R. 988, 992 (W.D. Wis. 1984). The Bankruptcy Court found that "[t]he evidence supports a finding that [the Department's] failure to timely file the instant claim by the bar date was not intentional or deliberate." *Stoecker*, 202 B.R. at 465. The Trustee's request for equitable subordination was therefore denied. Accordingly, we find that the Bankruptcy Court's ruling is not clearly erroneous and affirm.

E. The Department Did Not Issue The Notice Of Penalty Liability In Violation Of The Automatic Stay

Prior to the Department issuing a Notice of Penalty Liability on June 15, 1991, an automatic stay provided by 11 U.S.C. § 362(a) was in effect over the Debtor's estate. The automatic stay preserves the status quo as of the date of the bankruptcy filing. *See In re Carlson*, 189 B.R. 454, 458 (Bankr. N.D. Ill. 1995), *aff'd*, 198 B.R. 949 (N.D. Ill. 1996), *aff'd*, 126 F.3d 915 (7th Cir. 1997), *cert. denied*, 118 S. Ct. 1388 (1998). The Trustee contends that the Department violated this stay by filing its Notice of Penalty Liability and thus, the Notice is void.

Pursuant to 11 U.S.C. § 362(c), an automatic stay is no longer in effect under the following circumstances:

> (1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and
>
> (2) the stay of any other act under subsection (a) of this section continues until the earliest of –
>
> (A) the time the case is closed;
>
> (B) the time the case is dismissed; or
>
> (C) if the case is a case under chapter 7 of this title concerning an individual . . . , *the time a discharge is granted or denied.*

(emphasis added).

The Department asserts that, when it made its claims against the Debtor, it did so against the Debtor and not

against the Debtor's estate. Furthermore, as the Bankruptcy Court noted, the Debtor consented to a denial of his discharge on November 28, 1990. *In re Stoecker*, 202 B.R. at 445. Thus, pursuant to the plain language of § 362(c)(2)(C), the automatic stay was not in effect as to the Debtor when the Department's actions were taken. The Bankruptcy Court ruled that "the [Notice of Penalty Liability] is not void because the automatic stay as to the Debtor and his property was no longer in effect as of November 28, 1990. Hence, the Court finds [the Department's] actions were not in violation of the automatic stay." *In re Stoecker*, 202 B.R. at 445. Additionally, the Bankruptcy Court rejected the Trustee's contention that the Department's actions were against the Debtor's estate and thus violative of the stay provided in § 362(c)(1). *Id.* We affirm the Bankruptcy Court's reasoning on this issue and find that it is not clearly erroneous.

III. CONCLUSION

For the foregoing reasons, we affirm the decision of the Bankruptcy Court granting in part the Trustee's motion for summary judgment. We affirm the Bankruptcy Court's finding that the Debtor was not a responsible officer who willfully failed to pay the use tax assessed against Chandler. The Trustee's objection to the Department's proof of claim is sustained and the claim is, therefore, disallowed.

In addition, pursuant to the Tax Injunction Act, we find that under the circumstances of the instant matter, the Bankruptcy Court does not have jurisdiction to redetermine the tax liability of Chandler, a third party

non-debtor. Accordingly, we reverse the Bankruptcy Court's finding that Chandler did not owe the assessed use tax. Had it become necessary to reach the issue of equitable subordination, we would affirm the Bankruptcy Court's decision not to equitably subordinate the Department's claim. Finally, we affirm the Bankruptcy Court's finding that the Department's Notice of Penalty Liability was not issued in violation of the automatic stay.

It is so ordered.

/s/ Wayne R. Andersen
Wayne R. Andersen
United States District Judge

Dated: September 10, 1998

APPENDIX C

In re William J. STOECKER, Debtor.

Bankruptcy No. 89 B 02873.

United States Bankruptcy Court,
N.D. Illinois,
Eastern Division.

Oct. 17, 1996.

Robert Radasevich, George M. Hoffman, David A. Eide, Neal Gerber & Eisenberg, Chicago, IL, for Thomas E. Raleigh, Chapter 7 Trustee.

James W. Newbold, Assistant Attorney General, Office of the Attorney General, Chicago, IL, for Illinois Department of Revenue.

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MEMORANDUM OPINION

JOHN H. SQUIRES, Bankruptcy Judge.

This matter comes before the Court on a remand order from the United States District Court for the Northern District of Illinois to determine whether William J.

Stoecker (the "Debtor"), as a responsible officer of a non-debtor corporation, Chandler Enterprises, Inc. ("Chandler"), willfully failed to pay a use tax assessed against Chandler. A motion for summary judgment on this and related issues was filed by Thomas E. Raleigh, the Chapter 7 trustee (the "Trustee") for the Debtor's estate, which is opposed by the responding creditor claimant, the Illinois Department of Revenue ("IDOR"). For the reasons set forth herein, the Court hereby partially grants the motion for summary judgment. The Trustee's objection to IDOR's claim is sustained in part and the claim is disallowed. The Court holds that Chandler did not owe the assessed use tax in the first instance. Moreover, the Court holds that IDOR has failed to prove that the Debtor willfully failed to pay the use tax. Finally, the Court will not equitably subordinate IDOR's claim under 11 U.S.C. § 510(c).

I. *JURISDICTION AND PROCEDURE*

The Court has jurisdiction to entertain this matter pursuant to 28 U.S.C. § 1334(b) and General Rule 2.33(A) of the United States District Court for the Northern District of Illinois. This matter constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(B).[1] *See In re Stoecker*, 151 B.R.

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[1] IDOR does not dispute the Court's jurisdiction to hear an objection to its claim against the Debtor. IDOR contends that the Court lacks jurisdiction to determine the tax liability of a non-debtor corporation such as Chandler. The District Court, in reversing and remanding the matter, held that this Court had the jurisdiction to decide Chandler's liability for the assessed use tax. *See In re Stoecker*, 179 B.R. 532, 541 (N.D.Ill.1994). IDOR has raised the issue at this stage to preserve same for possible appeal. A more detailed address of this argument can be found herein. *See* pp. 445-52 *infra*.

989, 991 (Bankr.N.D.Ill.1992), *rev'd and remanded*, 179 B.R. 532 (N.D.Ill.1994).

II. *APPLICABLE STANDARDS*

A. *Burden of Proof for a Contested Proof of Claim*

Pursuant to Federal Rule of Bankruptcy Procedure 3001(f), "[a] proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." Fed.R.Bankr.P. 3001(f); *see also* 11 U.S.C. §§ 501 and 502(a). Claim objectors carry the initial burden to produce some evidence to overcome this rebuttable presumption. *Bank of Bellwood v. Stoecker (In re Stoecker)*, 143 B.R. 879, 883 (N.D.Ill.1992), *aff'd in part vacated in part*, 5 F.3d 1022 (7th Cir.1993). However, the ultimate burden of persuasion always remains with the claimant to prove entitlement to the claim. *Franchise Tax Board of the State of California v. MacFarlane*, 83 F.3d 1041, 1045 (9th Cir.1996); *Brown v. Internal Revenue Service (In re Brown)*, 82 F.3d 801, 804-05 (8th Cir.1996); *In re Octagon Roofing*, 156 B.R. 214, 218 (Bankr.N.D.Ill.1993). IDOR's properly filed claim constitutes prima facie evidence of the validity and amount of the claim. The Trustee has the burden of presenting evidence to rebut the prima facie validity. If that burden is satisfied, IDOR then bears the ultimate burden of proving its claim. *See MacFarlane*, 83 F.3d at 1045.

B. *Summary Judgment Under Federal Rule of Civil Procedure 56 and Federal Rule of Bankruptcy Procedure 7056*

In order to prevail on a motion for summary judgment, the movant must meet the statutory criteria set forth in Rule 56 of the Federal Rules of Civil Procedure, made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7056. Rule 56(c) reads in part:

> [T]he judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed.R.Civ.P. 56(c). The primary purpose for granting a summary judgment motion is to avoid unnecessary trials when there is no genuine issue of material fact in dispute. *Trautvetter v. Quick*, 916 F.2d 1140, 1147 (7th Cir.1990); *Farries v. Stanadyne/Chicago Div.*, 832 F.2d 374, 378 (7th Cir.1987) (quoting *Wainwright Bank & Trust Co. v. Railroadmen's Federal Sav. & Loan Ass'n of Indianapolis*, 806 F.2d 146, 149 (7th Cir.1986)).

In 1986, the United States Supreme Court decided a trilogy of cases which encourage the use of summary judgment as a means to dispose of factually unsupported claims. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); *Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986); *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). The burden is on the

Yachts, 29 F.3d 1153, 1156 (7th Cir.1994). "Summary judgment is not an appropriate occasion for weighing the evidence; rather the inquiry is limited to determining if there is a genuine issue for trial." *Lohorn v. Michal*, 913 F.2d 327, 331 (7th Cir.1990). However, "[i]f evidence opposing summary judgment is merely colorable or is not significantly probative, summary judgment may be granted." *Anderson*, 477 U.S. at 249-50, 106 S.Ct. at 2511 (citations omitted); *see also Griffin v. Air Line Pilots Ass'n. Int'l.*, 32 F.3d 1079, 1084 (7th Cir.1994). When the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no genuine issue for trial and summary judgment must be granted. *Matsushita*, 475 U.S. at 587, 106 S.Ct. at 1356.

C. *Summary Judgment Implemented by Local Bankruptcy Rule 402*

Local Rule 402.M of the Bankruptcy Rules adopted for the Northern District of Illinois requires the party moving for summary judgment to file, among other things, a detailed statement ("402.M statement") of material facts that the movant believes are uncontested. Local Bankr.R. 402.M.[2] The 402.M statement "shall consist of

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[2] M. Motions for Summary Judgment; Moving Party.

With each motion for summary judgment filed pursuant to Fed.R.Civ.P. 56 (Fed.R.Bankr.P. 7056), the moving party shall serve and file –

(1) any affidavits and other materials referred to in Fed.R.Civ.P. 56(e);

(2) a supporting memorandum of law; and

The party opposing a summary judgment motion is required by Local Rule 402.N to respond ("402.N statement") to the movant's 402.M statement, paragraph by paragraph, and to set forth any material facts that would require denial of summary judgment, specifically referring to the record for support of each denial of fact. Local Bankr.R. 402.N.[3] The 402.N statement filed by IDOR complies with Rule 402.N. In the filing, IDOR responds "to each numbered paragraph in the moving party's statement" and makes "specific references to the affidavits,

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[3] N. Motions for Summary Judgment; Opposing Party.

Each party opposing a motion under Fed.R.Civ.P. 56 (Fed.R.Bankr.P. 7056) shall serve and file the following:

(1) any opposing affidavits and other materials referred to in Fed.R.Civ.P. 56(e);

(2) a supporting memorandum of law; and

(3) a concise response to the movant's statement of facts that shall contain:

(a) a response to each numbered paragraph in the moving party's statement, including, in the case of any disagreement, specific references to the affidavits, parts of the record, and other supporting materials relied upon; and

(b) a statement, consisting of short numbered paragraphs, of any additional facts that require the denial of summary judgment, including references to the affidavits, parts of the record, and other supporting materials relied upon. All material facts set forth in the statement required of the moving party will be deemed to be admitted unless controverted by the statement of the opposing party.

Local Bankr.R. 402.N.

Trustee's reply to IDOR's 402.N statement, and from the entire record before the Court are as follows:

On February 21, 1989, an involuntary proceeding under Chapter 11 of the Bankruptcy Code was initiated against the Debtor. On March 20, 1989, Thomas E. Raleigh was appointed Chapter 11 Trustee of the Debtor's estate. Thereafter, on February 26, 1990, this case was converted to a Chapter 7, and Raleigh was reappointed as the Chapter 7 Trustee. By order dated March 5, 1990, the Court set the 11 U.S.C. § 341 meeting of creditors for March 28, 1990. That order provided that all proofs of claim were to be filed within 90 days after the § 341 meeting, on or before June 26, 1990. On November 28, 1990, pursuant to an agreed order, the Debtor consented to the denial of his discharge.

A. *IDOR's Procedures re Bankruptcy Cases of Taxpayer Debtors*

It is the practice of IDOR's bankruptcy unit, upon receiving notice that an individual has filed, voluntarily or involuntarily, for bankruptcy relief, to research all potential liability that person may have to IDOR by running a computer search using the debtor's social security number. (Tr. (MacDonald) 103).[4] Such a search reveals the names and Illinois business tax numbers of all corporations of which a debtor is an officer, provided that the corporation is registered with IDOR. *Id.* Once the computer search reveals that a debtor in bankruptcy is an

[4] Transcript references are to the testimony received during the 1992 evidentiary hearings.

officer of a corporation registered in Illinois, two things happen. First, a search is made to see if the corporation has outstanding taxes due IDOR. (Tr. (MacDonald) 103-04). If it is determined that there are outstanding corporate taxes and the debtor may be held personally liable for the corporate taxes as a responsible officer, the bankruptcy unit files a claim in the bankruptcy case. *Id.* Second, the bankruptcy unit encodes IDOR's computer system with information indicating that an officer of a corporation is in bankruptcy so that any employee of IDOR who checks the information concerning the corporation will know immediately that the officer is in bankruptcy. (Tr. (Petersen) 111).

The actions set forth above are performed for a number of reasons including the purpose of informing IDOR's auditors of the pendency of any bankruptcy case involving an officer of any corporation against which they may conduct an audit. *Id.* If an auditor finds that an officer of a corporation that he is auditing is in bankruptcy, it is IDOR's procedure to require the auditor to immediately advise the bankruptcy unit of any audit so that a claim can be promptly filed. (Tr. (Russell) 43).

B. *IDOR's Procedures Applied in the Debtor's Case*

IDOR's bankruptcy unit in Chicago received notice of the Debtor's bankruptcy filing sometime shortly after the filing of the involuntary petition. Upon receipt of the notice of the Debtor's bankruptcy filing, Lawrence MacDonald ("MacDonald") of IDOR's bankruptcy unit, was assigned the task of researching the Debtor's liability to IDOR and filing the appropriate claims. (Tr. (MacDonald)

102-03). As part of MacDonald's research, he ran the Debtor's social security number through IDOR's computer system and determined that there were a number of corporations of which the Debtor was an officer. (Tr. (MacDonald) 103). The corporations associated with the Debtor included The Cook's Cupboard, Inc., Eagle Line, Inc., and a number of other corporations. (Tr. (MacDonald) 103-04). MacDonald's search of IDOR's then extant database revealed no outstanding tax liability owed by corporations other than The Cook's Cupboard, Inc. and Eagle Line, Inc. (Tr. (MacDonald) 104). IDOR's computer records containing the registration information concerning these other corporations were encoded to show that the Debtor, as an officer, was in bankruptcy. (Tr. (Petersen) 115-16). At the time this was done in 1989, IDOR had no registration for Chandler that could be encoded to show that the Debtor, as an officer of Chandler, was in bankruptcy. *Id.* Apparently, Chandler was not registered with IDOR when the search was performed. *Id.*

C. *IDOR's Other Timely Filed Claims Not in Dispute Here*

On July 25, 1989, prior to conversion of the case to a Chapter 7, IDOR filed three proofs of claim in the amounts of $12,667.00, $1,330.21, and $222.03. These proofs of claim were for taxes owed by the Debtor as the responsible officer of The Cooks' Cupboard, Inc.[5] and

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[5] On November 17, 1989, IDOR filed an amended proof of claim asserting additional taxes owed by the Debtor as responsible officer of The Cook's Cupboard, Inc.

Prewitt & Associates") transferred title to Prewitt Leasing.[9] (IDOR's Exhibit No. 6). Title was previously transferred to Jack Prewitt & Associates by Opex Aviation, Inc. on June 1, 1988. (IDOR's Exhibit No. 5). Opex Aviation, Inc. had obtained title to the Aircraft from Bezwada Investments, Inc., an Australian company ("Bezwada"), on May 30, 1988. (Trustee's Exhibit No. 8). Due to a mistake on the part of Raymond Prewitt or William White, a now deceased employee of Jack Prewitt & Associates, title to the Aircraft was incorrectly transferred from Opex Aviation, Inc. to Jack Prewitt & Associates. (Jack Prewitt Dep. 41-44). Instead, on June 1, 1988, title should have been transferred from Opex Aviation, Inc. to Prewitt Leasing. *Id.*

Neither Chandler nor Prewitt Leasing paid any sales or use tax in connection with Chandler's purchase of the Aircraft. The purchase of the Aircraft was financed by NEMLC Leasing Corporation ("NEMLC") of Boston, Massachusetts. At NEMLC's request, John Anderson ("Anderson"), an attorney with the law firm of Lord, Bissell & Brook, who acted as counsel for Chandler and Grabill Corporation, a company that leased the Aircraft from Chandler, issued an opinion letter on September 30,

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[9] IDOR fails to deny or admit this statement in its 402.N statement. The failure to properly or adequately controvert proper assertions in the 402.M statement of facts results in the assertions being deemed admitted. *South Cent. Bank & Trust Co. v. Citicorp Credit Servs., Inc.*, 863 F.Supp. 635, 643 n. 10 (N.D.Ill.1994). *Accord Davis v. Frapolly*, 756 F.Supp. 1065, 1069 n. 4 (N.D.Ill.1991). Consequently, pursuant to Local Bankr.R. 402.N(3)(b), this material fact set forth by the Trustee is deemed to be admitted because same has not been controverted.

was an officer and director of Chandler. (IDOR's Exhibit Nos. 19 and 20). As a part of his assignment, Russell obtained a report of various aircraft purchased by Illinois residents from a company named Aerofax. (Tr. (Russell) 16). Aerofax is a company that obtains reports from the Federal Aviation Administration in Oklahoma City of all sales of aircraft in the United States and disseminates these reports to all parties subscribing to its reporting service. *Id.* The Aerofax report showed a transaction in which title was transferred to Jack Prewitt & Associates, out of Bedford, Texas, to Chandler in Oak Forest, Illinois. (Tr. (Russell) 17).

Chandler never registered with IDOR nor did it file any tax returns with IDOR, including any tax returns with respect to its purchase of the Aircraft. (Tr. (Russell) 41-42). After Chandler acquired the Aircraft, it did not register the Aircraft with the Illinois Department of Transportation's Division of Aeronautics. (IDOR's Exhibit No. 21). Furthermore, it is undisputed that Chandler never sought from IDOR a determination that the purchase of the Aircraft was exempt from tax.

IDOR determined that Chandler owed an unpaid use tax, and therefore assessed a use tax totaling $836,500 (plus interest and penalties) against Chandler for the purchase of the Aircraft. (IDOR's Exhibit No. 4). On March 7, 1990, and June 7, 1990, IDOR sent Chandler two letters demanding payment of the use tax. (IDOR's Exhibit Nos. 3 and 4). IDOR did not receive a response to either letter. (Tr. (Russell) 22). In June 1990, Russell learned that the Debtor was an officer of Chandler and, at

15, 1991, IDOR issued a Notice of Lien to the Debtor. (Trustee's Exhibit No. 5). On September 25, 1991, IDOR issued a demand to the Debtor for full and immediate payment of the use tax liability claimed. (IDOR's Exhibit No. 13). On October 3, 1991, IDOR recorded with the Cook County Recorder of Deeds a lien in the amount of $1,476,196.86, representing the assessed use tax, penalties, and interest. (Trustee's Exhibit No. 6).

E. *The Instant Claim Objection and Proceedings Prior to the Remand Order and Subsequent Thereto*

In January 1992, Brenda Towers, supervisor of the notice of penalty liability section of IDOR, was advised that the Debtor had filed bankruptcy (Tr. (Towers) 98). On January 21, 1992, nearly two years after IDOR began its investigation and more than one and one-half years after the claims bar date, and approximately one and one-half years after Russell discovered that the Debtor was an officer of Chandler, and almost three years after IDOR first received notice that the Debtor was in bankruptcy, IDOR filed the proof of claim that is the subject of this claim objection. (IDOR's Exhibit No. 17).[12] The basis for

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[12] The amount claimed by IDOR pursuant to its amended claim is as follows: a 11 U.S.C. § 507(a)(7) priority claim of $911,769 consisting of $868,351 in use tax and $43,418 in pre-petition interest. IDOR concedes that the penalty portion of its claim, namely, $260,505 is not entitled to priority, and in fact, is subordinated to claims of general unsecured creditors pursuant to 11 U.S.C. § 726(a)(4).

The total amount in the original claim was $1,476,197. (IDOR's Exhibit No. 17). The difference in the amounts set forth

the Aircraft without paying retailers' occupation tax/use tax (Ill.Rev.Stat., ch. 120, ¶ 440 *et seq.* and ¶ 439.1 *et seq.* (1991)). The Trustee objected to IDOR's claim, and on July 30, and August 27, 1992, the Court held evidentiary hearings.

On November 25, 1992, the Court entered a Memorandum Opinion and Order finding that IDOR had failed to establish that the Debtor willfully failed to pay or owed the responsible officer penalty resulting from Chandler's failure to pay the claimed use tax. *See Stoecker*, 151 B.R. at 1000-01. Further, the Court found that IDOR's claim was untimely and would not be allowed. *Id.* at 996-98.

The Court's decision was appealed to the United States District Court for the Northern District of Illinois. On August 31, 1994, Judge Andersen reversed the Court's finding that the bar date for filing claims in the Debtor's Chapter 7 case applied to IDOR's priority tax claim under 11 U.S.C. § 507(a)(7),[13] and reversed the Court's decision to disallow the claim on the merits. *See Stoecker*, 179 B.R. at 533-39. Further, the District Court remanded this matter to determine whether the Debtor was a responsible officer who willfully failed to pay an assessed tax against

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computation of the unpaid use tax claimed by IDOR to be owed, but unpaid, by Chandler.

[13] The Bankruptcy Code has been amended since this case was filed in 1989, and has changed the designations of certain sections and subsections at issue in this contested proceeding. Section 507(a)(7) was recodified as § 507(a)(8). References to sections and subsections of the Bankruptcy Code in this Opinion, however, are to the text of the Code in effect when the case was filed in 1989.

who willfully failed to pay the use tax allegedly owed; and (4) IDOR's claim is untimely. Additionally, the Trustee argues that if the Court finds IDOR's claim proper, it should be equitably subordinated pursuant to 11 U.S.C. § 510(c). The Court will address the bases for the Trustee's objection to IDOR's claim in turn.[14]

IV. *DISCUSSION*

A. *Did IDOR Issue the NPL in Violation of the Automatic Stay, Thus Rendering It Void?*

The Trustee contends that IDOR violated the automatic stay in the following post-petition instances: (1) when it issued the NPL against the Debtor on June 15, 1991; (2) when it made the demand for full payment of the NPL from the Debtor on September 25, 1991; and (3) when it recorded the lien against the Debtor on October 3, 1991.[15] IDOR does not dispute that it took such actions.

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[14] The Court previously sustained the Trustee's objection that IDOR's claim is untimely. *See Stoecker*, 151 B.R. at 996-98. However, the District Court reversed this Court's decision on this issue. 179 B.R. at 539. Accordingly, the Court is bound to follow that ruling as law of the case. *See Cole Energy Dev. Co. v. Ingersoll-Rand Co.*, 8 F.3d 607, 609 (7th Cir.1993) (law of the case doctrine requires lower court judge to comply with rulings made by higher court in the same case). The Trustee has reasserted this ground at this stage solely to preserve the issue in the event of future appeals. This Court will not further address this issue.

[15] At the time IDOR took the actions in question, there was in effect the automatic stay provided in Section 362(a) of the Bankruptcy Code, 11 U.S.C. § 362(a). Section 362(a) provides in relevant part, as follows:

The Trustee argues that § 362(c)(2)(C) does not apply to the matter at bar because IDOR seeks to employ the NPL to obtain property of the bankruptcy estate, not merely to proceed against the Debtor and his post-petition property. The Trustee contends that because IDOR is now seeking to obtain satisfaction of its claim from property of the estate, relying on the prima facie validity that attached to the NPL, that the post-petition NPL issued to the Debtor violates the automatic stay. The Trustee states that it is undisputed that the assets from which IDOR seeks recovery on its claim are funds in the Trustee's possession realized from the liquidation of the Debtor's prepetition property, and constitute property of the estate. According to the Trustee then, the denial of the Debtor's discharge is irrelevant to IDOR's claim against the estate because § 362(c)(1) and not § 363(c)(2)(C) applies in this case. As such, the Trustee argues the automatic stay, which prevents actions taken against property of the estate, was still in effect when the NPL was issued, currently remains in effect, the actions taken violated the stay, and the NPL is void.

IDOR claims that when it issued the NPL to the Debtor, made demand upon him, and recorded the lien, it did so against the Debtor and not against the estate. Thus, IDOR concludes that § 363(c)(2)(C) applies and the automatic stay was not in effect when it took these three actions against the Debtor. IDOR maintains that it never asserted that this lien was against the Trustee or property of the estate, and thus, there was no violation of the stay.

The Court agrees with IDOR's position because it was not until January 21, 1992, that IDOR sought to recover its claim from property of the bankruptcy estate

sovereign immunity since the District Court's decision, in which the District Court held that this Court properly found that it had jurisdiction under 11 U.S.C. § 505(a) to determine the tax liability of a non-debtor, third party such as Chandler.[16] Accordingly, IDOR maintains that the Court should reconsider that earlier decision based upon these Supreme Court cases.

1. *Sovereign Immunity Does Not Prevent the Court From Redetermining Chandler's Liability For the Use Tax*

Initially, the Court must address IDOR's argument that the Court is precluded under the principle of sovereign immunity from redetermining Chandler's liability for the use tax. This argument was previously raised and rejected by both this Court and the District Court. *See Stoecker,* 151 B.R. at 998-99; *Stoecker,* 179 B.R. at 541. Section 106 of the Bankruptcy Code was amended by the Bankruptcy Reform Act of 1994.[17] *See* Bankruptcy Reform

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[16] *Stoecker,* 179 B.R. at 541; *see also Stoecker,* 151 B.R. at 998-99. The Court stands by its reasoning contained therein, and will not repeat its analysis and discussion.

[17] Section 113 of the Bankruptcy Reform Act provides in relevant part:

> Section 106 of title 11, United States Code, is amended to read as follows:
>
> (a) Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section with respect to the following
>
> (1) Sections 105, 106, 107, 108, 303, 346, 362, 363, 364, 365, 366, 502, 503, 505, 506, 510, 522, 523, 524, 525,

Act of 1994, Pub.L. No. 103-394, § 113, 108 Stat. 4106 (1994). Most significantly, the amendment to § 106 applies

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> 542, 543, 544, 545, 546, 547, 548, 549, 550, 551, 552, 553, 722, 724, 726, 728, 744, 749, 764, 901, 922, 926, 928, 929, 944, 1107, 1141, 1142, 1143, 1146, 1201, 1203, 1205, 1206, 1227, 1231, 1301, 1303, 1305, and 1327 of this title.
>
> (2) The court may hear and determine any issue arising with respect to the application of such sections to governmental units.
>
> (3) The court may issue against a governmental unit an order, process, or judgment under such sections or the Federal Rules of Bankruptcy Procedure, including an order or judgment awarding a money recovery, but not including an award of punitive damages. Such order or judgment for costs or fees under this title or the Federal Rules of Bankruptcy Procedure against any governmental unit shall be consistent with the provisions and limitations of section 2412(d)(2)(A) of title 28.
>
> (4) The enforcement of any such order, process, or judgment against any governmental unit shall be consistent with appropriate nonbankruptcy law applicable to such governmental unit and, in the case of a money judgment against the United States, shall be paid as if it is a judgment rendered by a district court of the United States.
>
> (5) Nothing in this section shall create any substantive claim for relief or cause of action not otherwise existing under this title, the Federal Rules of Bankruptcy Procedure, or nonbankruptcy law.
>
> (b) A governmental unit that has filed a proof of claim in the case is deemed to have waived sovereign immunity with respect to a claim against such governmental unit that is property

retroactively. *Id.* § 702(b)(2)(B) ("The amendments made by sections 113 and 117 shall apply with respect to cases commenced under title 11 of the United States Code *before*, on, and after the date of the enactment of this Act.") (emphasis supplied).

Under § 106(a), as amended, sovereign immunity has been expressly abrogated as to contested claims like the instant claim, which IDOR seeks to have allowed under 11 U.S.C. § 502 and which, though late-filed, IDOR argues should be afforded priority under 11 U.S.C. § 507(a)(7). Amended § 106(b) expressly deems the filing of a proof of claim by a governmental unit to constitute a waiver of sovereign immunity with respect to any claim (like a § 362(a) violation) that is property of the estate and that arose out of the same "transaction or occurrence" out of which the government unit's claim arose.

IDOR cites to *Seminole Tribe of Florida v. Florida*, ___ U.S. ___, 116 S.Ct. 1114, 134 L.Ed.2d 252 (1996) in support of its proposition that the Court is precluded from redetermining Chandler's tax liability. Therein, the Court specifically held that the Indian Commerce Clause does

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of the estate and that arose out of the same transaction or occurrence out of which the claim of such governmental unit arose.

(c) Notwithstanding any assertion of sovereign immunity by a governmental unit, there shall be offset against a claim or interest of a governmental unit any claim against such governmental unit that is property of the estate.

not grant Congress the power to abrogate states' sovereign immunity.[18] *Seminole* involved the Indian Gaming Regulatory Act (the "Act"),[19] which permitted an Indian tribe to conduct certain gaming activities within a state only if the tribe and the state first entered into a compact prescribing the conditions under which such activities would be conducted. The Act imposed on states a duty to negotiate with tribes in good faith in an attempt to form such pacts.[20] A tribe that believed a state had not negotiated in good faith could bring an action in federal court against that state.[21]

Pursuant to the Act, the Seminole Tribe brought suit against the State of Florida and its governor, alleging a failure to negotiate a gaming compact in good faith. The defendants moved to dismiss the action on the basis of sovereign immunity. The motion was denied. On interlocutory appeal, the Eleventh Circuit reversed the district court, holding that the action against both defendants was barred by the Eleventh Amendment.[22] The Supreme

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[18] The Court noted that no principled distinction can be drawn between the Indian Commerce Clause and the Interstate Commerce Clause. No discussion of the Bankruptcy Clause was made in the majority opinion, although it was referenced in Justice Stevens' dissent. *See* 116 S.Ct. at 1142.

[19] 25 U.S.C. § 2701 *et seq.*

[20] 25 U.S.C. § 2710(d)(3)(A).

[21] 25 U.S.C. § 2710(d)(7)(A)(i), (B)(i).

[22] The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State." U.S. CONST. amend. XI.

Court affirmed the dismissal. The Court held that the Eleventh Amendment prevents Congress, acting pursuant to its Article I powers, from subjecting unconsenting states to suits brought by private parties in federal court. The Court also held that the governor and the State of Florida were immune from suit. The Court opined that Congress could not statutorily abrogate sovereign immunity for the states in the exercise of its Article I powers – even as to matters within the exclusive control of the federal government. Thus, the Court held that the Indian Gaming Regulatory Act's provision permitting tribes to sue unconsenting states in federal court was unconstitutional.

Next, IDOR cites to the Supreme Court's vacatur of *In re Merchants Grain, Inc.*, 59 F.3d 630 (7th Cir.1995), *vacated sub nom. Ohio Agric. Commodity Depositors Fund v. Mahern*, ___ U.S. ___, 116 S.Ct. 1411, 134 L.Ed.2d 537 (1996). IDOR contends that to the extent that *Seminole* left any question as to the applicability of its holding to Congressional abrogation of sovereign immunity under the Bankruptcy Clause, the issue was clarified when the Supreme Court granted certiorari in *Merchants Grain*, reversed the Seventh Circuit's decision, and remanded the case for further consideration in light of *Seminole*. In *Merchants Grain*, the Seventh Circuit permitted a bankruptcy trustee to maintain an action against an agency of the State of Ohio for the recovery of alleged preferential transfers.

IDOR contends that in light of *Seminole* and *Merchants Grain*, there are only two instances when a bankruptcy court would have jurisdiction over a proceeding involving a state. According to IDOR, the first instance

would be where federal jurisdiction is sought to enjoin a state official from engaging in an ongoing violation of state law under the doctrine set forth in *Ex parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908).[23] The second instance is where the state has waived its immunity by filing a claim. IDOR maintains that neither circumstance applies to the matter at bar.

IDOR does not dispute that the Court has jurisdiction to determine the allowance of its "responsible officer" claim against the Debtor. However, IDOR argues that its filing of a claim against the Debtor for responsible officer liability is separate and distinct from its claim against Chandler, and the filing of the responsible officer claim against the Debtor did not waive IDOR's sovereign immunity so as to allow the Court to redetermine Chandler's liability for the alleged use tax.

The Court holds that sovereign immunity does not bar the Court from redetermining Chandler's tax liability. The fact that IDOR's claim against Chandler and the Debtor are separate and distinct liabilities does not trigger sovereign immunity and the Eleventh Amendment. The matter at bar is a contested claim proceeding – a bankruptcy trustee's objection to a claim filed by a state agency. There is no action brought by the Trustee involuntarily forcing IDOR to unwillingly defend a motion or related adversary proceeding in this Court. IDOR voluntarily consented to the limited subject matter jurisdiction and the equitable powers of this Court and the claim

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[23] This matter does not seek to enjoin a state official from engaging in an ongoing violation of state law. Thus, *Young* is inapplicable to the matter at bar.

procedures under the Bankruptcy Code when it filed its proof of claim.

The Eleventh Amendment therefore plays no role in this objection to IDOR's late-filed claim. The issue in the cases cited by IDOR is the extent to which Congress is empowered to abrogate state sovereign immunity and allow suits against states. This present proceeding – an objection to a claim – is not the functional equivalent of a private party's suit against an unwilling state. The Court's determination of whether a state tax is owed does not implicate the Eleventh Amendment. *See Scheffel v. New York State Dept. of Taxation and Finance (In re Lehal Realty Assocs.)*, 133 B.R. 9, 12 (Bankr.S.D.N.Y.1991) ("In the absence of a demand for a money judgment against a state, the issue of sovereign immunity is not implicated because 11 U.S.C. § 505(a)(1) expressly authorizes this court to 'determine the amount or legality of any tax. . . . '"), *vacated*, 184 B.R. 205 (Bankr.S.D.N.Y.1993). Accordingly, the Court concludes that Eleventh Amendment sovereign immunity is not implicated in this contested claim proceeding because the Trustee makes no demand for a money judgment or other similar relief against IDOR.

Moreover, even if Illinois' sovereign immunity were implicated, the Court finds that IDOR has waived such sovereign immunity defense by filing proofs of claim in the Debtor's bankruptcy case. The majority of cases have held that filing a proof of claim waives the defense of sovereign immunity. *See, e.g., University Medical Center v. Sullivan (In re University Medical Center)*, 973 F.2d 1065, 1086 (3d Cir.1992); *995 Fifth Ave. Assocs., L.P. v. New York State Dept. of Taxation and Finance (In re 995 Fifth Ave. Assocs., L.P.)*, 963 F.2d 503, 509 (2d Cir.), *cert. denied*, 506

U.S. 947, 113 S.Ct. 395, 121 L.Ed.2d 302 (1992); *Sullivan v. Town & Country Home Nursing Servs., Inc. (In re Town & Country Home Nursing Servs., Inc.)*, 963 F.2d 1146, 1150 (9th Cir.1992); *Anderson v. Federal Deposit Ins. Corp.*, 918 F.2d 1139, 1143-44 (4th Cir.1990). By filing proofs of claim, IDOR has voluntarily submitted itself to the equitable jurisdiction of this Court, and coincidentally, has waived the right to have this matter tried before a jury. *See Langenkamp v. Culp*, 498 U.S. 42, 44-45, 111 S.Ct. 330, 331-32, 112 L.Ed.2d 343 (1990); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 58-59, 109 S.Ct. 2782, 2799, 106 L.Ed.2d 26 (1989); *Katchen v. Landy*, 382 U.S. 323, 326, 86 S.Ct. 467, 470-71, 15 L.Ed.2d 391 (1966). These cases lead to the inevitable conclusion that when creditors voluntarily participate in a debtor's bankruptcy case by filing proofs of claim, they thereby consent to have their rights determined as against the bankruptcy estate, and to have the bankruptcy estate's rights determined as against them. If the constitutional right to trial by jury can be waived by the mere filing of the proof of claim, as noted in *Langenkamp, Granfinanciera,* and *Katchen,* so too can IDOR's defense of sovereign immunity. Such a defense is in essence an indirect challenge to the exercise of this Court's in personam jurisdiction. Creditors cannot pick and choose at will. Either they assert sovereign immunity and do not file proofs of claim, but stand suit properly asserting such defenses, as was done in *Leber v. Illinois Dept. of Revenue (In re Leber)*, 134 B.R. 911 (Bankr.N.D. Ill.1991), or as here, where IDOR effectively waived the immunity defenses and subjected itself to the Court's jurisdiction by filing proofs of claim.

IDOR counters that Chandler is not a debtor in bankruptcy and that IDOR has never filed a claim against Chandler for use tax liability in a bankruptcy case involving Chandler. Rather, as the argument goes, the Court would only have jurisdiction to redetermine IDOR's final assessment for use tax against Chandler if Chandler filed a bankruptcy petition, and if IDOR filed a claim in Chandler's bankruptcy case, it would waive its sovereign immunity. Instead, IDOR has filed claims in the Debtor's bankruptcy case, and thus, IDOR has not waived its sovereign immunity under the Eleventh Amendment to allow the Court to make a redetermination of Chandler's tax liability.

The Court also rejects this argument. First, as previously noted in the Opinion and Order of November 25, 1992, the Court found that the provisions of § 505(a)(1) allowed the Court to determine Chandler's tax liability. *See Stoecker*, 151 B.R. at 998-99. That point was affirmed by the District Court in its opinion. *See Stoecker*, 179 B.R. at 541. Thus, it is the law of the case and should be followed. Moreover, amended § 106(a)(1) expressly references § 505, showing Congressional intent to legislate abrogation of state sovereign immunity in matters within the scope and reach of § 505. Furthermore, the issue of the Debtor's alleged liability are related and linked to Chandler's alleged liability for non-payment of the assessed use tax. Although a corporate officer may be able to avoid personal liability for an unpaid Illinois use tax properly owed by a corporation by which the officer is claimed responsible, it defies logic to say such officer could be held so liable if in fact and in law the corporation is not liable for the claimed use tax. IDOR cannot

have it both ways and invoke the equitable powers of the Court under the Bankruptcy Code and file a claim to be paid out of the bankruptcy estate assets based on a derivative liability of the Debtor for his alleged willful failure to pay the claimed penalty, without implicating the possible defense that the underlying tax was improperly assessed against Chandler.

2. *The Sale of the Aircraft Was an "Isolated or Occasional Sale" Exempt From Tax*

The District Court specifically instructed this Court that if it "finds that the Debtor wilfully failed to pay the use tax assessed against Chandler, the Court must also make the finding that Chandler owed the assessed tax." *Stoecker*, 179 B.R. at 541. The Trustee argues that the tax upon which IDOR's proof of claim is based was never actually owed by Chandler because the sale of the Aircraft was exempt from the ROTA/use tax as an "isolated or occasional sale" under Ill.Rev.Stat., ch. 120, ¶ 439.2 (1989).[24] The basis for the "occasional sale" exemption is

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[24] Section 2 of ROTA provides that "a tax is imposed on persons engaged in the business of selling tangible personal property at retail. . . . " Section 1 of ROTA defines the "occasional sale" exemption as follows:

> The isolated or occasional sale of tangible personal property at retail by a person who does not hold himself out as being engaged (or who does not habitually engage) in selling such tangible personal property at retail . . . does not constitute engaging in a business of selling such tangible personal property at retail within the meaning of this Act. . . .

Ill.Rev.Stat., ch. 120, ¶ 440 (1989).

found in Section 3 of the Use Tax Act, Ill.Rev.Stat., ch. 120, ¶ 439.3 (1989).[25] The regulation adopted under the provisions of the Use Tax Act provides further insight:

> Any person who habitually engages in selling tangible personal property for use or consumption, or who, in any manner or at any time, advertises, solicits, offers for sale or holds himself out to the public to be a seller of tangible personal property for use or consumption . . . is engaged in the business that is taxed by this Act. . . .

Ill.Admin.Code tit. 86, § 130.115. Based on the statutory provisions and regulation, it is clear that for a person making sales of tangible personal property for use to be exempt from the application of ROTA as an "occasional seller," two conditions must be met. First, the seller must not habitually engage in the sale for use or consumption of the type of tangible property at issue. Second, the seller must not advertise, solicit, offer for sale, or hold himself out to the public as a seller of tangible personal property for use or consumption.

The Trustee argues that Chandler is not liable for the use tax on two theories. First, the Trustee contends that the sale of the Aircraft to Chandler was an "occasional

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[25] Section 3 of the Use Tax Act provides:

> If the seller of tangible personal property for use would not be taxable under the Retailers' Occupation Tax Act despite all elements of the sale occurring in Illinois, then the tax imposed by this Act shall not apply to the use of such tangible personal property in this State.

Ill.Rev.Stat., ch. 120, ¶ 439.3 (1989).

sale" exempt from use tax. Second, the Trustee states that although the title of the Aircraft was previously transferred from Bezwada, then to Opex Aviation, Inc., then to Jack Prewitt & Associates, who transferred it to Prewitt Leasing, who in turn sold the Aircraft to Chandler, for purposes of analyzing the tax consequences, the sale of the Aircraft should be viewed as a sale from Bezwada to Chandler, which the Trustee asserts, is exempt as an "occasional sale."

IDOR, on the other hand, argues that Jack Prewitt & Associates, a predecessor in the chain of title to the Aircraft, was a retailer of aircraft, and hence, the sale was taxable. IDOR maintains that because Jack Prewitt & Associates had been in title to the Aircraft and that title thereto was transferred from Jack Prewitt & Associates to Prewitt Leasing on the same day that Chandler purchased the Aircraft, the sale was not "isolated or occasional" because Jack Prewitt & Associates was a retailer of aircraft.

The evidence adduced on this issue was as follows: Jack Prewitt, president of Prewitt Leasing, testified that Prewitt Leasing, not Jack Prewitt & Associates, bought and owned the Aircraft and resold it to Chandler. (Jack Prewitt Dep. 29-30; Jack Prewitt Dep. Exhibit No. 9; IDOR's Exhibit No. 7). Prewitt Leasing, a company not engaged in the retail sale of aircraft, actually sold the Aircraft to Chandler. (Jack Prewitt Dep. 7). Jack Prewitt testified that title was inadvertently initially placed in Jack Prewitt & Associates, although it provided none of the funds used to purchase the Aircraft and received no part of the sales commissions. (Jack Prewitt Dep. 41-42, 56-57, 85-86). The error was attributed by Jack Prewitt to

his nephew, Raymond Prewitt, who had only recently joined Prewitt Leasing, and to an error by the salesman, who was having medical problems at the time and died shortly after the transaction. (Jack Prewitt Dep. 41). This error was discovered prior to the closing of the Aircraft sale, which occurred on September 30, 1988. (Jack Prewitt Dep. 101-02). Thus, at closing, title was transferred from Jack Prewitt & Associates to Prewitt Leasing to Chandler. (IDOR's Exhibit Nos. 6 and 7).

The Court finds that IDOR failed to introduce any evidence that Chandler or the Debtor knew that Jack Prewitt & Associates had been in title to the Aircraft, or that title to the Aircraft had been transferred from Jack Prewitt & Associates to Prewitt Leasing on the same day that Chandler purchased the Aircraft. The Court further finds that this error did not change the true character of the transaction – an "occasional sale" from a non-retailer, Prewitt Leasing to Chandler. Although a retailer, Jack Prewitt & Associates, through the above errors, held title to the Aircraft for a period of time, Prewitt Leasing was the party who actually purchase [sic] the Aircraft from Opex Aviation, Inc. and sold the Aircraft to Chandler, not Jack Prewitt & Associates.

Anderson offered an alternative analysis of the transaction, namely that it was really a sale from Bezwada to Chandler, with some intermediate title transfers that did not affect the substance of the transaction. (Tr. (Anderson) 128-29; Trustee's Exhibit No. 3). IDOR contends that the intervening transfers cannot be ignored and, even so, there was no evidence that Bezwada was not a retailer. Jack Prewitt described this type of transaction as a "back-to-back" transaction. (Jack Prewitt Dep. 111-12).

Although title passed through intermediate brokers, including Jack Prewitt & Associates, the sale was from Bezwada, a non-retailer, to Chandler. Anderson testified, without contradiction, that Bezwada "was not a dealer." (Tr. (Anderson) 128; Trustee's Exhibit No. 3 at 2).

Thus, the Court finds that the sale from Prewitt Leasing to Chandler qualifies as an "occasional sale" exempt from proper assessment of the Illinois use tax. Jack Prewitt testified that Prewitt Leasing purchased the Aircraft, that Prewitt Leasing leased and then sold the Aircraft to Chandler, and that Prewitt Leasing was in the leasing business, having sold only one aircraft prior to the transaction at issue. (Jack Prewitt Dep. 29-30, 76-77; Trustee's Exhibit No. 4; Jack Prewitt Dep. Exhibit No. 9 at 2, ¶ 4(d)); *see also* (Raymond Prewitt Dep. 11-13). IDOR has offered no contrary evidence.

3. ***The Court Will Not Disregard the Separate Legal Entities of Prewitt Leasing and Jack Prewitt & Associates and Thus Find That Prewitt Leasing Was Not an "Occasional" Seller of Aircraft***

IDOR further asserts that Prewitt Leasing and Jack Prewitt & Associates were integrated companies with common ownership and common employees and were acting in concert in selling the Aircraft to Chandler. Therefore, IDOR concludes that Prewitt Leasing acted in concert with Jack Prewitt & Associates, which regularly sold aircraft at retail, and hence, Prewitt Leasing cannot be considered an "occasional" seller with respect to the sale of the Aircraft to Chandler.

In effect, IDOR argues that the Court should pierce the corporate veils of Prewitt Leasing and Jack Prewitt & Associates, collapse these two corporations into one, and treat the latter as the seller of the Aircraft to Chandler. IDOR's mere allegation that Jack Prewitt & Associates and Prewitt Leasing are one entity does not, however, render Prewitt Leasing and Jack Prewitt & Associates as the same entity. The Court will not disregard the legal fiction of separate corporate entities and pierce a corporate veil without adequate supporting evidence.

The uncontroverted evidence is that Prewitt Leasing, not Jack Prewitt & Associates, acquired the Aircraft from Opex Aviation, Inc.[26] (Jack Prewitt Dep. 29-30). Jack Prewitt testified that Prewitt Leasing had the funds necessary to acquire the Aircraft. *Id.* Jack Prewitt & Associates did not. (Jack Prewitt Dep. 36, 58). Furthermore, the commission on the sale, $150,000, went entirely to Prewitt Leasing. Jack Prewitt & Associates received nothing. (Jack Prewitt Dep. 56-57).

It is true that Jack Prewitt Holding Company, another company associated with Jack Prewitt, filed consolidated tax returns, which included Jack Prewitt & Associates and Prewitt Leasing; that at times, Jack Prewitt & Associates and Prewitt Leasing advertised their services jointly; that

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[26] Jack Prewitt stated that Opex Aviation, Inc. only held naked title – it did not own the Aircraft. (Jack Prewitt Dep. 115-16). Prewitt speculated that Opex Aviation, Inc. held title because the Aircraft originated in Australia and needed to be titled to a United States entity prior to sale. *Id.*

occasionally Jack Prewitt & Associates and Prewitt Leasing referred customers to each other; that the two companies had common employees; and that they operated out of the same location. This does not demonstrate, especially in light of the other uncontroverted evidence, that Prewitt Leasing is a retailer of aircraft; nor does it prove that Jack Prewitt & Associates sold the Aircraft to Chandler.

Generally, Illinois law treats a corporation as a legal entity separate and distinct from other corporations or individuals with which it may be affiliated. *Main Bank of Chicago v. Baker*, 86 Ill.2d 188, 204, 56 Ill.Dec. 14, 21, 427 N.E.2d 94, 101 (1981); *Van Dorn Co. v. Future Chemical and Oil Corp.*, 753 F.2d 565, 569 (7th Cir.1985). The Illinois Supreme Court has recognized, however, that a corporate entity will be disregarded, and its veil of limited liability pierced, when two requirements are met: (1) there must be such a unity of interest and ownership that the separate personalities of the two corporations no longer exist; and (2) adherence to the fiction of separate corporate existence would sanction a fraud or promote an injustice. *Main Bank*, 86 Ill.2d at 205, 56 Ill.Dec. at 21, 427 N.E.2d at 101; *Van Dorn*, 753 F.2d at 569-70. Factors that the Illinois courts have considered in the determination of whether the first prong of the test has been met are: (1) the failure to maintain adequate corporate records or to comply with corporate formalities; (2) the commingling of funds or assets; (3) undercapitalization; and (4) one corporation treating the assets of another corporation as its own. *Main Bank*, 86 Ill.2d at 205-06, 56 Ill.Dec. at 22, 427 N.E.2d at 102.

IDOR has failed to present any evidence to demonstrate that there is a unity of interest and ownership between Jack Prewitt & Associates and Prewitt Leasing such that the separate juridical entities of the two corporations no longer exist. The mere fact that Jack Prewitt is president of both corporations and that they advertise together does not warrant disregarding the corporate entities as separate and distinct from one another. IDOR offered no evidence that the two corporations failed to maintain adequate corporate records or to comply with corporate formalities; that the corporations commingled funds or assets; that either corporation is undercapitalized; or that one corporation treats the assets of the other corporation as its own. Absent a showing of one or more of these factors, the Court will not pierce the corporate veil of Prewitt Leasing and collapse these two distinct corporations into one and find that the sale to Chandler was really made by Jack Prewitt & Associates.

The Court finds that Chandler's purchase of the Aircraft was a purchase from a non-retailer, with some intermediate title transfers that did not affect the substance of the transaction with another non-retailer. The Court finds that Prewitt Leasing owned the Aircraft at and prior to its sale to Chandler. (Jack Prewitt Dep. 29-30; Jack Prewitt Dep. Exhibit No. 9). Prewitt Leasing sold the Aircraft to Chandler. (IDOR's Exhibit No. 7; Jack Prewitt Dep. Exhibit No. 9). The sale of the Aircraft from Prewitt Leasing to Chandler was, therefore, an "occasional sale," exempt from Illinois use tax.

C. *Was the Debtor a Responsible Officer Who Willfully Failed to Pay the Use Tax Assessed Against Chandler?*[27]

The District Court held that this Court erred in finding that IDOR failed to meet its burden regarding whether the Debtor willfully failed to pay the tax assessed against Chandler. *Stoecker*, 179 B.R. at 541-44. The District Court held that IDOR's determination of a penalty due against a responsible individual, as evidenced by the NPL, establishes a prima facie case regarding all the statutory elements required for the imposition of such a penalty. *Id.* 544. The District Court noted that a taxpayer has better access to his or her records and witnesses to rebut the claim of willfulness. *Id.* Thus, the burden shifts to the Trustee to rebut the prima facie weight accorded the NPL. *Id.*[28]

1. *The Law of the Case Doctrine Prevents the Court From Not Considering the NPL as Prima Facie Evidence*

The law of the case doctrine requires a lower court judge to comply with the rulings made by higher courts

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[27] Notwithstanding the fact that the Court has determined that Chandler did not properly owe the assessed use tax, the Court nevertheless will address the issue of whether the Debtor's failure to pay the tax was willful. In the interest of completing the record and because the District Court specifically remanded this issue, the Court will decide same.

[28] As noted above, the NPL was not issued in violation of the automatic stay and is not void. The Trustee's argument that the NPL cannot constitute prima facie evidence in this case is therefore without merit.

in the same case. *See State of Arizona v. State of California*, 460 U.S. 605, 618, 103 S.Ct. 1382, 1391, 75 L.Ed.2d 318 (1983); *Cole Energy Dev. Co. v. Ingersoll-Rand Co.*, 8 F.3d 607, 609 (7th Cir.1993) (citations omitted). "[E]xplicit rulings on issues that were before the higher court and explicit directives by that court to the lower court concerning proceedings on remand are not dicta." *Id.* (citations omitted). The law of the case will not be enforced, however, where it is clearly erroneous or where doing so would produce an injustice. *Redfield v. Continental Casualty Corp.*, 818 F.2d 596, 605 (7th Cir.1987) (citations omitted). Previously decided determinations are not applied if there are reasons rendering the doctrine inapplicable, such as: (1) substantial new evidence introduced after the first review; (2) a decision of the United States Supreme Court after the first review; or (3) a conviction on the part of the second reviewing court that the decision of the first was clearly erroneous. *Key v. Sullivan*, 925 F.2d 1056, 1060 (7th Cir.1991) (citation omitted); *Parts and Elec. Motors, Inc. v. Sterling Elec. Inc.*, 866 F.2d 228, 231 (7th Cir.1988), *cert. denied*, 493 U.S. 847, 110 S.Ct. 141, 107 L.Ed.2d 100 (1989).

In remanding the case, the District Court held that "[t]he NPL *shall* be considered prima facie proof of the Debtor's willfulness which the Trustee will have the burden to rebut. . . . After hearing all the evidence offered by the parties, the Bankruptcy Court should determine whether the Trustee successfully proved that the Debtor's inaction was not willful." *Stoecker*, 179 B.R. at 544 (emphasis supplied). The District Court found that the NPL constituted prima facie proof of all elements of

responsible officer liability including the element of willfulness, and that the burden was on the Trustee to establish that the Debtor's failure to pay the tax was not willful.

The Court finds and concludes that it is bound to follow the District Court's directive. There has been no substantial new evidence introduced to this Court after the District Court's decision; no decision of the United States Supreme Court has been rendered that deals with the issues at bar; and this Court does not possess a conviction that the decision of the District Court was clearly erroneous.[29] The District Court clearly held that the NPL shall be considered prima facie evidence of the Debtor's willfulness. *Stoecker*, 179 B.R. at 544. Accordingly, the Court will discuss whether the Trustee introduced evidence sufficient to adequately demonstrate that the Debtor's failure to pay IDOR pursuant to the NPL was not willful, thereby successfully rebutting the presumption of willfulness.

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[29] While this Court respectfully disagrees with some of the District Court's conclusions, this Court is not willing to make a determination that same were clearly erroneous, notwithstanding this Court's opinion that its findings and conclusions contained in its Opinion and Order dated November 25, 1992 were correct and represent the better view of the matter. *See Stoecker*, 151 B.R. 989. Rather, the Court acknowledges the hierarchy in the federal judiciary from which flows the doctrines of law of the case and stare decisis – two doctrines which the Court believes it must and should follow.

2. *Applicable Statutes and Case Law Regarding Responsible Officer Liability*

IDOR argues that the evidence clearly shows that the Debtor's failure to pay the use tax was, at the very least, a reckless disregard for a known risk of violation and therefore was willful. The Trustee, on the other hand, contends that the evidence, namely the opinion letter by Anderson, indicates that the transaction was an occasional sale and thus not taxable. The Trustee further submits that the representations of the seller demonstrate that the Aircraft purchase was properly claimed exempt from the use tax. The Trustee further argues that even if Anderson's opinion letter and the representations made to Chandler from the seller were incorrect, the Debtor's reliance on same negates any inference of willfulness on his part.

Section 13½ of the Retailers' Occupation Tax Act ("ROTA") provides that a responsible individual may be liable for taxes under certain circumstances when a corporate taxpayer fails to pay the taxes.[30]

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[30] Section 13½ of ROTA provides in relevant part:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax here imposed . . . and who willfully fails to file such return or to make any such payment to [IDOR] or who willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon. . . .

Ill.Rev.Stat., ch. 120, ¶ 452½ (1991).

In *Branson v. Department of Revenue*, 168 Ill.2d 247, 213 Ill.Dec. 615, 659 N.E.2d 961 (1995), decided after the Court's Opinion and Order dated November 25, 1992, the Illinois Supreme Court defined the willful failure to pay taxes for purposes of Section 13½ of ROTA as involving "intentional, knowing and voluntary acts" or, alternatively, "reckless disregard for obvious or known risks" which includes "gross negligence involving a known risk of violation." 168 Ill.2d at 255, 213 Ill.Dec. at 620, 659 N.E.2d at 965; *see also Department of Revenue v. Heartland Invs., Inc.*, 106 Ill.2d 19, 29, 86 Ill.Dec. 912, 917, 476 N.E.2d 413, 418 (1985); *Department of Revenue v. Joseph Bublick & Sons, Inc.*, 68 Ill.2d 568, 577, 12 Ill.Dec. 265, 269, 369 N.E.2d 1279, 1283 (1977) ("a voluntary, conscious and intentional failure satisfies the requirements of 'wilfully fail' "). Willfulness is determined by whether (1) the Debtor knew the tax was due and (2) nonpayment of the tax resulted from the voluntary, conscious, and intentional failure to pay by the Debtor. *See Department of Revenue v. Corrosion Systems, Inc.*, 185 Ill.App.3d 580, 583-85, 133 Ill.Dec. 647, 650, 541 N.E.2d 858, 861 (4th Dist.1989); *Department of Revenue v. Marion Sopko, Inc.*, 84 Ill.App.3d 953, 955-56, 40 Ill.Dec. 487, 488, 406 N.E.2d 188, 189 (2d Dist.1980). *See also People ex rel. Dept. of Revenue v. National Liquors Empire, Inc.*, 157 Ill.App.3d 434, 439, 109 Ill.Dec. 627, 631, 510 N.E.2d 495, 499 (4th Dist.1987). ("A person must have knowledge to voluntarily, consciously and intentionally fail to file and pay the correct amount of taxes due.").

To establish that the Debtor was a responsible party, the requisite inquiry under ROTA is whether the Debtor had "control, supervision or responsibility for filing

returns and making payment of the amount of tax herein imposed. . . . " Ill.Rev.Stat., ch. 120, ¶ 452½ (1991).

3. *The Evidence Did Not Show That the Debtor Had Control, Supervision, or Responsibility for Filing Returns and Making Payment of the Tax Allegedly Owed By Chandler*

The Trustee argues that IDOR offered no evidence that the Debtor was in control, or had the supervision or responsibility over Chandler's payment of taxes within the meaning of ROTA. The Trustee contends that all of the evidence demonstrated that Pluhar, not the Debtor, was in charge of the day to day operations and financial responsibilities of Chandler. Thereby, the Trustee maintains that he has submitted substantive evidence rebutting the prima facie effect of the NPL.

The Trustee introduced evidence that Pluhar was the Chandler officer responsible for the payment of Chandler's bills and taxes. Anderson, counsel for Chandler, testified that Pluhar functioned as the Debtor's chief financial officer. (Tr. (Anderson) 131). Anderson discussed with Pluhar the "potential tax ramifications of the sale [of the Aircraft]." (Tr. (Anderson) 134). Anderson also testified that in addition to Pluhar, he dealt with George Weiler on behalf of Chandler, not with the Debtor. (Tr. (Anderson) 125). Pluhar signed the Aircraft Purchase Agreement (Jack Prewitt Dep. Exhibit No. 9 at 5), and was the person from Chandler with the most involvement in the purchase. (Jack Prewitt Dep. Exhibit No. 14). There is no direct evidence, however, linking the Debtor to

Chandler's day to day operations and the payment of its bills and taxes in the course of its business.

IDOR offered evidence that the Debtor was the president and a director of Chandler. (IDOR's Exhibit No. 19). Based on this evidence, IDOR summarily concludes that the Debtor was the responsible party. Further, IDOR points to the Aircraft Lease/Purchase Agreement, which was signed by the Debtor. (Jack Prewitt Dep. Exhibit No. 3 at 10).

The Seventh Circuit in *Monday v. United States*, 421 F.2d 1210 (7th Cir.), *cert. denied*, 400 U.S. 821, 91 S.Ct. 38, 27 L.Ed.2d 48 (1970) has held, however, that holding corporate office, alone, is insufficient to establish responsible party liability.

> Corporate office does not, *per se*, impose the duty to collect, account for and pay over the withheld taxes. On the other hand, an officer may have such a duty even though he is not the disbursing officer. . . . Liability attaches to those with power and responsibility within the corporate structure for seeing that the taxes withheld from various sources are remitted to the Government. . . . This duty is generally found in high corporate officials charged with general control over corporate business affairs who participate in decisions concerning payment of creditors and disbursal of funds.

Id. at 1214-15 (determination of responsible party liability under Internal Revenue Code) (citations omitted).[31] Other

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[31] Illinois case law recognizes that reference to analogous federal case law interpreting the federal responsible officer

courts have likewise held that the authority of a corporate officer alone is insufficient to establish responsible party liability. *See In re Premo*, 116 B.R. 515, 525 (Bankr.E.D.Mich.1990) (responsible party liability under Internal Revenue Code).

The Seventh Circuit addressed "responsible person" liability within the meaning of Section 6672 of the Internal Revenue Code, a provision somewhat analogous to Section 13½ of ROTA, in *United States Internal Revenue Service v. Charlton*, 2 F.3d 237 (7th Cir.1993). In order to determine whether a person is a "responsible person" within the meaning of Section 6672, the Seventh Circuit opined:

> Whether such a duty exists depends on whether the taxpayer has "significant control or authority over an enterprise's finances or general decision-making." Relevant factors include the holding of an entrepreneurial stake in a company, the holding of corporate office, the authority to disburse funds on behalf of the company, the ability to take out loans on behalf of the company and the ability to hire and fire employees. The true objective of this inquiry, and the sine qua non of liability under section 6672, is a determination that the taxpayer had the authority to allocate funds to pay the company's other debts in preference to its debt to the IRS.

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statute is appropriate in interpreting the responsible officer provisions of ROTA. *See Branson*, 168 Ill.2d at 261-62, 213 Ill.Dec. at 622, 659 N.E.2d at 968; *Heartland*, 106 Ill.2d at 29-30, 86 Ill.Dec. at 916-17, 476 N.E.2d at 417-18.

Id. at 240 (citations omitted). *See also In re Tripplett*, 115 B.R. 955, 963-64 (Bankr.N.D.Ill.1990). In *Charlton*, the court found evidence that the defendant held a substantial entrepreneurial stake in the companies; he was a member of the boards of directors of all of the corporations, and secretary of several of them. 2 F.3d at 240. Further, the defendant had the authority to borrow money on behalf of the corporations and to disburse the companies' funds. *Id.* The court specifically rejected the defendant's argument that while he had the titular authority to disburse the corporations' funds, he had delegated that responsibility to others. *Id.* The court noted that delegation of disbursal authority does not relieve the delegator of liability. *Id.* (citation omitted). The court stated that "a corporate president who relies on others for routine calculation and payment of taxes *may* also be held liable." *Id.* (citation omitted and emphasis supplied).

The Court finds that IDOR failed to introduce sufficient evidence to adequately prove that the Debtor had actual control, supervision, or responsibility for making payment of the tax allegedly owed by Chandler. The mere fact that the Debtor was the president of Chandler did not ipso facto impose upon him the duty of paying Chandler's taxes or being the responsible officer for paying Chandler's various bills. The limited evidence adduced showed that Pluhar, not the Debtor, was responsible for and in control of Chandler's finances. IDOR failed to introduce any evidence that the Debtor in fact exercised any authority or controlled the payment of Chandler's taxes. The Court is not willing without more, however, to equate potential authority with de facto or de

jure duty. The logical conclusion of IDOR's argument seems to be that the Debtor, by virtue of his status as president, director, and shareholder of Chandler, was in control of Chandler's payment of expenses and taxes. The Court is unwilling to functionally relegate the Debtor to becoming a personal guarantor of the claimed unpaid taxes assessed against Chandler without any evidence to show that the Debtor was actually in control of Chandler's financial affairs.

As the Court previously stated, the Court can reasonably infer that the Debtor, as such officer and director, had ultimate general control of Chandler's affairs. *See Stoecker*, 151 B.R. at 1000. Anderson's testimony that he dealt primarily with Pluhar and Weiler while representing Chandler (Tr. (Anderson) 125, 131, and 134) does not establish that the Debtor in fact exercised any authority or control to determine whether taxes should be paid. As president of Chandler, the Debtor certainly held an entrepreneurial stake in Chandler, and he may have possessed the potential authority to disburse funds on behalf of the company, and may have had the ability to take out loans on behalf of Chandler, or the ability to hire and fire employees. However, there was no testimony that the Debtor exercised any authority or power to determine whether taxes should be paid. What is lacking here is any evidence to show any actual exercise of control by the Debtor as summarily concluded by IDOR. Mere status as a corporate officer is insufficient to subject a debtor to the responsible person liability. There must be some evidence of actual control, supervision, or responsibility.

The Court finds that IDOR's NPL, together with the Debtor's status as corporate officer, director, and shareholder does not establish that the Debtor exercised control over Chandler's finances and payment of its taxes. Rather, the evidence leads the Court to conclude that he delegated such authority and power to Pluhar. Because there is no evidence before the Court to show that the Debtor had control, supervision, or responsibility for the payment of Chandler's taxes, there can be no finding that the Debtor took any action that can be construed as voluntary, conscious, and intentional or in reckless disregard with respect to any failure to pay assessed taxes.

4. *The Debtor's Failure to Pay the Tax Was Not Shown To Be Voluntary, Conscious, and Intentional*

Even if the Debtor was in control, or had the supervision or responsibility for filing tax returns and making payment of taxes owed by Chandler, the Court will next address whether the Debtor's actions in failing to pay the assessed use tax were voluntary, conscious, and intentional. The evidence adduced demonstrated the following:

Anderson's opinion letter was supported by the "Certificate Re Occasional Seller Exemption from Illinois Sales and Use Tax" signed by Prewitt Leasing's vice president on September 30, 1988. (Trustee's Exhibit No. 4; Tr. (Anderson) 132). Anderson never issued the opinion letter to Chandler or any of its officers. Nevertheless, Anderson gave Pluhar a copy of the legal opinion letter.

(Tr. (Anderson) 130-31). The accuracy of the representations contained in the Certificate and the Aircraft Purchase Agreement were confirmed by the president of Prewitt Leasing, Jack Prewitt. (Jack Prewitt Dep. 3-4, 76-77; Prewitt Dep. Exhibit No. 9 at 2, ¶ 4(d)) ("Prewitt [Leasing] is not a manufacturer of aircraft or a dealer or distributor of aircraft. . . . "). Anderson discussed the tax implications of the Aircraft purchase with Pluhar. Anderson testified that Pluhar stated: "This transaction is really an occasional sale. You're buying this aircraft from Bezwada, but with all of these interbreeding transfers, you've muddied the waters here; and if, you know, that because of all these transfers, [IDOR] could construct an argument that the tax is due." (Tr. (Anderson) 134). Anderson replied: "I don't think a tax is due but you've got to understand that because of these transfers it's not as clear cut as it was when – if you just gave the money to Bezwada and took title to the [A]ircraft." (Tr. (Anderson) 135).

IDOR argues that the Trustee provided no evidence that the Debtor actually relied on Anderson's letter to NEMLC in not paying the tax. IDOR contends that the Trustee is asking the Court to infer reliance. IDOR maintains that such an inference is not proper for two reasons: (1) other evidence suggests that Chandler and the Debtor attempted to avoid the issue of whether tax was due on the purchase of the Aircraft by failing to file a use tax return, even one that claimed the purchase to be exempt, and Chandler did not register the Aircraft with the Illinois Department of Transportation Division of Aeronautics as required by Ill.Rev.Stat., ch. 15 1/2, ¶ 22.42 (1989); and (2) Anderson did not issue a similar legal opinion to

Chandler or the Debtor, and Anderson never sought a private letter ruling from IDOR on the issue of taxability of the sale. Thus, IDOR contends that to infer reliance by the Debtor on Anderson's letter in these circumstances would be improper.

The evidence suggests, however, that Pluhar, as corporate financial officer of Chandler, was responsible for the payment of taxes and other debts of the corporation. Thus, to the extent that the Debtor was in control of this function at all, he was acting through Pluhar, as his agent.

In Illinois, an agency is a consensual fiduciary relationship between two legal entities whereby the principal has the right to control the conduct of the agent and the agent has the power to effect the legal relations of the principal. *Greenfield Direct Response, Inc. v. ADCO List Management (In re Greenfield Direct Response, Inc.)*, 171 B.R. 848, 855 (Bankr.N.D.Ill.1994) (citations omitted). The key consideration in determining whether an agency relationship exists is whether the principal had the right to control the activities of the agent. *Oberlin v. Marlin American Corp.*, 596 F.2d 1322, 1326 (7th Cir.1979). Although existence of an agency relationship is a question of fact, it may be inferred from facts of a particular case. *Greenfield*, 171 B.R. at 855 (citations omitted). An agency relationship can be inferred from circumstantial evidence, including the situation occupied by the parties, their acts, and other relevant circumstances. *City of Evanston v. Piotrowicz*, 20 Ill.2d 512, 518, 170 N.E.2d 569, 573 (1960). To bind the principal, the agent must have either actual authority, apparent authority, or the principal must ratify the agent's actions. *Anetsberger v. Metropolitan Life Ins. Co.*, 14 F.3d 1226, 1234 (7th Cir.1994).

To the extent, if any, that the Debtor was in control of paying any taxes, the Court will infer an agency relationship between the Debtor and Pluhar. As an agent of the Debtor, Pluhar had the authority to bind the Debtor.

Furthermore, the Court finds that Pluhar, as the agent of the Debtor, reasonably relied on the legal opinion of Anderson supported by the Certificate from the seller. Reasonable reliance by a corporate officer on advice of his attorney or accountant in not paying a tax can obviate a finding of willfulness. *See Gray Line Co. v. Granquist*, 237 F.2d 390, 395 (9th Cir.1956) (refusing to find officer acted willfully where he relied on advice of competent counsel and tax collector that no tax was due), *cert. denied*, 353 U.S. 911, 77 S.Ct. 667, 1 L.Ed.2d 664 (1957); *Corrosion Systems*, 185 Ill.App.3d at 583-84, 133 Ill.Dec. at 650, 541 N.E.2d at 861 (holding that officer's reliance on accountant negated a finding that he acted consciously, voluntarily, intentionally, knowingly, or recklessly in his failure to pay tax). IDOR argues that there was no evidence submitted that the Debtor relied on Anderson's opinion letter, which was issued to NEMLC. The mere fact that the opinion letter was addressed to NEMLC, Chandler's lender, does not ipso facto mean that the Debtor would not have been able to rely upon the letter. After all, Anderson was counsel to Chandler, not NEMLC. (Trustee's Exhibit No. 3; Tr. (Anderson) 124-25).

The evidence submitted demonstrated that Pluhar, the individual officer responsible for Chandler's finances, (Tr. (Anderson) 131), did review Anderson's letter and had a discussion with Anderson regarding the potential taxability of the Aircraft purchase. The Court finds that Pluhar, as the officer responsible for Chandler's finances,

reasonably relied on this advice. Furthermore, because Pluhar was an agent of the Debtor, to the extent that the Debtor was in control at all, this reasonable reliance is imputed to the Debtor as principal.

Accordingly, the Court finds that the Debtor, through his agent Pluhar, relied on the opinion letter in deciding not to pay the use tax assessed against Chandler. Hence, the Debtor's reliance on this opinion letter negates a finding that he acted consciously, voluntarily, intentionally, knowingly, or recklessly in his failure to pay the assessed tax.

Additionally, the Court finds that Anderson's failure to seek a private letter ruling from IDOR that the sale of the Aircraft was not taxable does not prevent the Court from finding that the Debtor, through Pluhar, reasonably relied on Anderson's legal opinion letter. Even if the legal opinion and representations by the seller were incorrect, same negate any presumption that the Debtor acted willfully in failing to pay the tax. The Court therefore holds that the totality of the evidence does not demonstrate that the Debtor's failure to pay the tax showed a "gross negligence involving a known risk of violation" and was therefore willful.

5. *The Court Will Not Draw Any Inferences From the Debtor's Invocation of the Fifth Amendment Privilege*

There is no direct evidence that the Debtor had control in this situation or that he relied on Anderson's opinion letter because in response to questioning in this

matter, the Debtor asserted his Fifth Amendment privilege. IDOR argues that the Court should construe the Debtor's silence against him in making a determination of whether the Debtor's failure to pay the tax was willful. Specifically, IDOR maintains that it is properly entitled to rely on the negative inference arising from the Debtor's assertion of the Fifth Amendment privilege to the question of whether he actually relied on advice of counsel when he failed to pay the use tax.[32]

The Supreme Court in *Baxter v. Palmigiano*, 425 U.S. 308, 96 S.Ct. 1551, 47 L.Ed.2d 810 (1976) stated that "the Fifth Amendment does not forbid inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them: the Amendment 'does not preclude the inference where the privilege is claimed by a party to a Civil cause.' " *Id.* at 318, 96 S.Ct. at 1558 (citation omitted). In *Baxter*, an inmate of a Rhode

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[32] IDOR cites several cases in support of this proposition. *See Cerro Gordo Charity v. Fireman's Fund American Life Ins. Co.*, 819 F.2d 1471 (8th Cir.1987); *RAD Services, Inc. v. Aetna Casualty & Surety Co.*, 808 F.2d 271 (3d Cir.1986); *Brink's Inc. v. City of New York*, 717 F.2d 700 (2d Cir.1983). None of these cases are controlling or directly on point. The matter at bar does not involve a situation in which one of the litigants asserts a Fifth Amendment privilege relating to matters within the scope of his prior employment or board responsibilities. The Debtor is not a party to the instant contested claim. IDOR is the party claimant and the Trustee is the party objector. Moreover, this is not a case in which a conspirator has asserted his Fifth Amendment privilege in a case against his co-conspirator. *See United States v. District Council of New York and Vicinity of United Bhd. of Carpenters and Joiners of America*, 832 F.Supp. 644 (S.D.N.Y.1993); *Aetna Casualty & Surety Co. v. Rodco Autobody*, 138 F.R.D. 328 (D.Mass.1991).

Island prison was charged in a disciplinary proceeding with inciting a disturbance of prison operations. At a hearing in which he was told that he had the right to remain silent, but that if he did so, his silence would be used against him, the prisoner remained silent when faced with incriminating evidence. *Id.* at 312, 96 S.Ct. at 1555. The prison board placed the prisoner in segregation for thirty days and downgraded his institutional status. *Id.* at 313, 317, 96 S.Ct. at 1955-56, 1557. In *Lefkowitz v. Cunningham*, 431 U.S. 801, 97 S.Ct. 2132, 53 L.Ed.2d 1 (1977), the Supreme Court characterized the *Baxter* holding in this way:

> Baxter did no more than permit an inference to be drawn in a civil case from a party's refusal to testify. Respondent's silence in *Baxter* was only one of a number of factors to be considered by the finder of fact in assessing a penalty, and was given no more probative value than the facts of the case warranted; here, refusal to waive the Fifth Amendment privilege leads automatically and without more to imposition of sanctions.

Id. at 808 n. 5, 97 S.Ct. at 2137 n. 5.

The rule that adverse inferences may be drawn from Fifth Amendment silence in civil proceedings has been recognized by the Seventh Circuit. *See, e.g., Daniels v. Pipefitters' Ass'n Local Union No. 597*, 983 F.2d 800, 801-02 (7th Cir.1993); *National Acceptance Co. of America v. Bathalter*, 705 F.2d 924, 929-30 (7th Cir.1983). The inference against a witness that may be drawn from the invocation of the Fifth Amendment in a civil action is permissive. *Daniels*, 983 F.2d at 802. The language in *Baxter* indicates that the inference is not required; it may be drawn, but it

does not necessarily need to be drawn. *Daniels*, 983 F.2d at 802. Thus, although the Fifth Amendment does not forbid adverse inferences against parties to civil actions when they refuse to testify in response to probative evidence offered against them, an analysis of that evidence is nonetheless required.

The adverse inference that may be drawn when a party asserts the Fifth Amendment privilege is not a substitute for proof and cannot fill an evidentiary void. *See United States v. Rylander*, 460 U.S. 752, 758, 103 S.Ct. 1548, 1553, 75 L.Ed.2d 521 (1983). "Silence is a relevant factor to be considered in light of the proffered evidence, but the direct inference of guilt from silence is forbidden." *LaSalle Bank Lake View v. Seguban*, 54 F.3d 387, 390 (7th Cir.1995); *see also Bathalter*, 705 F.2d at 927-28 (failure to answer the allegations of a civil complaint based on the assertion of Fifth Amendment privilege cannot be construed as an admission).

The Court will not construe the Debtor's silence or invocation of the Fifth Amendment as an admission of his willfulness not to pay the assessed tax. To do so would constitute a substitute for proof and fill an evidentiary void. The Debtor is not a party to this contested claim and has never been involved in this matter. Rather, in objecting to IDOR's claim, the Trustee acts as the statutory representative of the Debtor's creditors. *Baxter* does not mandate an adverse inference against the Trustee in this claim objection proceeding wherein the Debtor has invoked the Fifth Amendment privilege. The Court declines to draw any inference whatsoever in this matter from the Debtor's timely and proper invocation of his Fifth Amendment privilege. The Debtor is currently

under indictment for federal bank fraud and other charges, and is awaiting trial in the District Court. Some of the charges relate to his involvement with Chandler. Hence, the Debtor's invocation of the Fifth Amendment is both understandable and proper.

To draw an adverse inference against the Trustee based upon the Debtor's invocation of the Fifth Amendment would unfairly prejudice the Trustee as well as the creditors of the Debtor's estate by punishing them for the Debtor's attempt to shield himself from criminal liability. In *Libutti v. United States*, 894 F.Supp. 589 (N.D.N.Y.1995), the court refused to draw an adverse inference in a tax suit against a litigant because of her father's assertion of the Fifth Amendment privilege. The court reasoned that:

> The government has not provided any cases in which a non-party witness' invocation of his Fifth Amendment privilege has resulted in drawing an adverse interest [sic] against a party where the non-party witness was not in some way a former member or employee of the party at issue. Additionally, the Second Circuit has held in a case where a non-party, who did not have a former member or employee relationship with the party at issue, invoked his Fifth Amendment privilege that "no adverse interest [sic] against appellees could have been drawn by his refusal to testify." *Brenner v. World Boxing Council*, 675 F.2d 445, 454 n. 7 (2d Cir.1982). Thus, the court in this case, refuses to draw an adverse inference against Edith LiButti because of Robert LiButti's assertion of his Fifth Amendment privileges.

Id. at 597.[33] The Court will not undercut the limited protection provided by the Fifth Amendment and effectively impose a civil penalty by making an adverse finding against the Debtor's bankruptcy Trustee or the estate for the Debtor's silence.

The Debtor has not cooperated with either the Trustee or IDOR in this matter. It is undisputed that neither side has an unfair advantage over the other or has suffered any remediable disadvantage because the Debtor has refused to cooperate with either party. The Debtor's failure to cooperate has not prevented effective cross-examination because neither party to this contested claim has had an opportunity to directly examine the Debtor. The Court, as the fact finder, is fully aware of the Debtor's invocation of the Fifth Amendment privilege. The Court has chosen, in its discretion, not to draw any inferences either against or for the Trustee or IDOR because of the Debtor's invocation of this privilege. The Court is not required to draw any inferences from the Debtor's invocation of the Fifth Amendment privilege. *See, e.g., Old Security Life Ins. Co. v. Continental Illinois Nat. Bank & Trust Co. of Chicago*, 740 F.2d 1384, 1398 (7th Cir.1984).

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[33] The Trustee argues that the only evidence offered by IDOR of the Debtor's willfulness is the allegedly invalid NPL (invalid because it was allegedly issued in violation of the automatic stay). However, as already noted above, the NPL did not violate the automatic stay, and therefore is not void. The District Court has already found the NPL constitutes prima facie proof of the Debtor's willfulness. Furthermore, IDOR has submitted other evidence of the Debtor's willfulness.

6. *The Use Tax Allegedly Owed By Chandler Arose on September 30, 1988*

Additionally, IDOR argues that the Debtor could not have relied on Anderson's opinion letter, which is dated September 30, 1988, because the alleged use tax arose on June 7, 1988, the date Chandler entered into the Aircraft Lease/Purchase Agreement.

IDOR correctly points out that the District Court, in remanding this matter, stated that the Court had discretion to reopen the proofs so that both parties could introduce additional evidence. *See Stoecker*, 179 B.R. at 544. IDOR states that it is not estopped from arguing that the taxable sale took place on June 7, 1988, in light of the new evidence introduced. IDOR contends that evidence was presented to the Court on April 29, 1996 in the form of depositions and exhibits that indicate the sale took place on June 7, 1988.

IDOR posits that this issue is important to the determination of this matter for two reasons. First, if Prewitt Leasing (assuming Prewitt Leasing was the party purchasing the Aircraft from Opex Aviation, Inc./Bezwada), purchased the Aircraft with the intention of leasing it to Chandler, Prewitt Leasing and not Chandler would be deemed the "user" for purposes of the Use Tax Act and Prewitt Leasing would have been the party responsible for the tax. If, however, Prewitt Leasing purchased the Aircraft for the purpose of resale, and the Aircraft Lease/Purchase Agreement is found to be a conditional sale, Chandler would be liable for the use tax at the time it entered into the Aircraft Lease/Purchase Agreement and took delivery of the Aircraft on June 7, 1988, unless the

sale is deemed an "occasional" sale. The second reason the date issue is important pertains to the Debtor's willfulness because IDOR asserts that the issue of willfulness is determined at the time the tax is incurred.

The evidence in the record shows that Anderson formulated his opinion before September 30, 1988, and discussed the tax aspects of the transaction with counsel for NEMLC and with Pluhar prior to September 30, 1988. (Tr. (Anderson) 125-26, 132, and 134). Moreover, the Court finds that the sale of the Aircraft to Chandler took place on September 30, 1988, not June 7, 1988. Several facts in evidence support this finding. First, the Aircraft Purchase Agreement between Prewitt Leasing and Chandler is dated September 30, 1988. (Jack Prewitt Dep. Exhibit No. 9). That agreement is fully integrated and provides:

> (b) This Agreement constitutes the entire understanding of the parties relating to the subject matter thereof, and supercedes all prior representations and agreements, written or oral, relating to the subject matter hereof.

Id. at 4. Second, the NPL upon which IDOR relies asserts that the Aircraft was purchased in September 1988. (IDOR's Exhibit No. 1). In addition, the NTL sent to Chandler also references September 1988 as the date Chandler purchased the Aircraft. (IDOR's Exhibit No. 10 at 2 and 5). Furthermore, the Aircraft bill of sale also shows that the Aircraft was purchased by Chandler on September 30, 1988. (IDOR's Exhibit No. 7). Finally, IDOR's proof of claim indicates a sale date of September 1988. (IDOR's Exhibit No. 17). Both this Court and the District Court found, based on the evidence submitted by

IDOR, that the Aircraft was sold to Chandler on September 30, 1988. *See Stoecker,* 151 B.R. at 992; *Stoecker,* 179 B.R. at 534.

7. *The Aircraft Lease/Purchase Agreement Between Chandler & Prewitt Leasing Was Not a Disguised Conditional Sale*

IDOR's argument that the Aircraft Lease/Purchase Agreement was really entered into between Prewitt Leasing and Chandler on June 7, 1988 when Chandler took delivery of the Aircraft on that same date, and the Lease/Purchase Agreement with option to buy was really a disguised conditional sale or security agreement and that it therefore gave rise to use tax liability, is likewise without merit. At his deposition, Jack Prewitt testified that the Aircraft was purchased for the purpose of reselling it to Chandler. (Jack Prewitt Dep. 24). Further, Jack Prewitt authenticated the Aircraft Lease/Purchase Agreement as the operative agreement pursuant to which Chandler took delivery of the Aircraft. (Jack Prewitt Dep. 51-52). Additionally, he testified that when Chandler "purchased" the Aircraft on September 30, 1988, it was exercising its buy out option pursuant to the Aircraft Lease/Purchase Agreement. (Jack Prewitt Dep. 66-67).

IDOR argues that the Aircraft Lease/Purchase Agreement required Chandler to pay a security deposit of $2,455,016 of which $2,405,016 could be applied to the buy out option price of $12,405,016. (Jack Prewitt Dep. Exhibit No. 3). The amount of additional funds needed by Chandler to exercise the buy out option was $10 million. According to IDOR, this $10 million was much less than

the appraised value of the Aircraft which was $12.5-12.7 million. IDOR concludes that the amount required to exercise the buy out option under the lease was substantially less than the fair market value of the property, thus, the lease should be deemed a conditional sale and not a true lease with an option to buy later exercised in September 1988 by Chandler.

To determine whether an agreement that purports to be a lease is a true lease or a security agreement, the Court must look to state law. *Powers v. Royce Inc. (In re Powers)*, 983 F.2d 88, 90 (7th Cir.1993) ("Ordinarily the existence, nature and extent to a security interest in property is governed by state law."). Arguably, the Federal Aviation Act, 49 U.S.C. § 40101 *et seq.* ("FAA"), applies. However, it is not necessary for this decision to determine whether the FAA, which creates a federal recording scheme, preempts the definition of a conditional sales contract.[34]

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[34] FAA creates, *inter alia*, a national recording scheme for air commerce. Most courts have held that although the FAA operates to determine whether a valid recording has occurred, in most other aspects of secured transactions it does not preempt state law. *See, e.g., Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1278 (8th Cir.1988) (holding that FAA does not preempt state law when determining date of perfection); *Gary Aircraft Corp. v. General Dynamics Corp. (In re Gary Aircraft Corp.)*, 681 F.2d 365, 372 (5th Cir.1982) (holds that FAA does not displace state law assignment of priorities to interests in aircraft), *cert. denied*, 462 U.S. 1131, 103 S.Ct. 3110, 77 L.Ed.2d 1366 (1983); *Danning v. World Airways, Inc. (In re Holiday Airlines Corp.)*, 647 F.2d 977, 980 (9th Cir.1981) (holds that FAA merely preempts validity of recording as against third parties; failure to record with FAA did not invalidate lien as against debtor), *cert. denied*, 454 U.S. 1146, 102 S.Ct. 1009, 71 L.Ed.2d 299 (1982).

In FAA § 40102, a "conveyance" is "an instrument, including a conditional sales contract, affecting title to, or an interest in, property." 49 U.S.C. § 40102(19). The FAA defines a conditional sales contract as:

> (A) for the sale of an aircraft, aircraft engine, propeller, appliance, or spare part, under which the buyer takes possession of the property but title to the property vests in the buyer at a later time on –
>
> (i) paying any part of the purchase price;
>
> (ii) performing another condition; or
>
> (iii) the happening of a contingency; or
>
> (B) to bail or lease an aircraft, aircraft engine, propeller, appliance, or spare part, under which the bailee or lessee –
>
> (i) agrees to pay an amount substantially equal to the value of the property; and
>
> (ii) is to become, or has the option of becoming, the owner of the property on complying with the contract.

49 U.S.C. § 40102(18).

Alternatively, under Illinois state law, to determine whether an agreement that purports to be a lease is a true lease or a security agreement, the Court must look to the Illinois Commercial Code, § 1-201(37), which provides in relevant part:

> "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. . . . Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a

transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee; and

> (a) the original term of the lease is equal to or greater than the remaining economic life of the goods;
>
> (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;
>
> (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement; or
>
> (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

810 ILCS 5/1-201(37). Section 1-207(37) also sets forth criterion which, found alone, would not be sufficient proof of a security agreement:

> A transaction does not create a security interest merely because it provides that:
>
> > (a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;
> >
> > (b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance,

> filing, recording, or registration fees, or service or maintenance costs with respect to the goods;
>
> (c) the lessee has an option to renew the lease or to become the owner of the goods;
>
> (d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or
>
> (e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

Id.

Under the Illinois statutory scheme, in determining whether an agreement that purports to be a lease is actually a security agreement, courts focus on three factors:

> (1) whether the "lessee" is required to make aggregate rental payments to the "lessor" equaling the cost of the leased property plus interest; (2) whether the option price to purchase the leased equipment at the end of the "lease" is nominal; and (3) whether the lease term covers the total useful life of the equipment.

Direct Air, Inc. v. Fairchild Aircraft, Inc. (In re Direct Air, Inc.), 189 B.R. 444, 452 (Bankr.N.D.Ill.1995) (citing *In re Hardy*, 146 B.R. 206, 209 (Bankr.N.D.Ill.1992)). "Substance rules over form and courts will look through a transfer absolute in form to find a secured transaction if that was

the real intent of the parties." *Turk v. Wright & Babcock, Ltd.*, 174 Ill.App.3d 139, 142, 124 Ill.Dec. 102, 103, 528 N.E.2d 993, 994 (3d Dist.1988), *appeal denied*, 124 Ill.2d 562, 129 Ill.Dec. 156, 535 N.E.2d 921 (1989); *see also Meeker v. Beeson*, 76 Ill.App.3d 940, 943, 32 Ill.Dec. 468, 470, 395 N.E.2d 698, 700 (5th Dist.1979) ("in determining the character of an alleged lease of personal property the courts will disregard the mere form and the words and will endeavor to reach the substance of the agreement"). There is a rebuttable presumption that what is labeled or denominated a lease is in fact a bona fide lease absent compelling factors to the contrary. *Liona Corp., N.V. v. PCH Assocs. (In re PCH Assocs.)*, 804 F.2d 193, 200 (2d Cir.1986). Thus, the burden of proving whether or not the lease is bona fide rests with IDOR.

The Court disagrees with IDOR's characterization of the Aircraft Lease/Purchase Agreement as a conditional sale and finds that IDOR has failed to meet its burden of proof on this issue. After close examination of the three factors set forth in *Direct Air*, the Court finds that the Aircraft Lease/Purchase Agreement was in fact a true lease. While the inclusion of an option to purchase in a lease does not in and of itself make the lease one intended for security, where the lessee can become the owner of the leased goods for only nominal consideration at the expiration of the lease, the transaction is in substance a conditional sale. *Orix Credit Alliance, Inc. v. Pappas*, 946 F.2d 1258, 1261 (7th Cir.1991). The option price was not nominal and there is no showing that the lease term covered the useful life of the Aircraft. The fact that Chandler needed additional funds of $10 million to exercise the buy out option when the Aircraft was

appraised at approximately $12.5-12.7 million does not demonstrate that the agreement was in the nature of a disguised sale. The $10 million dollar amount is not nominal nor is it substantially less than the fair market value of the Aircraft in a used condition in September 1988 when the option to purchase was exercised, three months after the Aircraft was leased by Chandler from Prewitt Leasing.

8. *IDOR Failed To Sustain Its Ultimate Burden of Proof*

As already noted above, the District Court held that the NPL was prima facie proof as to all elements of responsible officer liability, including willfulness. *See Stoecker*, 179 B.R. at 544. The burden then shifted to the Trustee to rebut the presumption created by a valid NPL. The presumption was rebutted by the Trustee showing that the Debtor was not in control and thus could not have voluntarily or willfully failed to pay the tax. Alternatively, the Trustee showed that even if the Debtor was in control, he reasonably relied on the legal opinion of Anderson through his agent, Pluhar. The ultimate burden of proof then shifted back to IDOR to show that the nonpayment was willful and to show that IDOR's amended claim should be allowed over the Trustee's objection. *See In re Chapman*, 132 B.R. 132, 143 (Bankr.N.D.Ill.1991) ("Once the objector has produced some evidence disputing the validity of the claim, the burden shifts to the claimant."). Based upon the above evidence, the Court holds that the Trustee has offered substantial evidence to rebut the presumption of willfulness that attached to the NPL and that IDOR has failed to

refute this evidence and to ultimately sustain its burden of proof by a preponderance of the evidence that the Debtor's failure to pay the penalty for Chandler's failure to remit the alleged use tax was willful.

D. *Should the Court Equitably Subordination IDOR's Claim?*[35]

1. *The Trustee's Request for Equitable Subordination is Properly Before the Court*

Initially, the Court will address IDOR's argument that the Trustee's request for equitable subordination is not properly before the Court because the Trustee failed to file an adversary proceeding or a motion for such relief. At the initial status hearing after the remand by the District Court, IDOR agreed to waive the filing of an adversary proceeding by the Trustee provided that he file a motion seeking equitable subordination. The Trustee did not file a motion seeking equitable subordination at that time. On August 22, 1995, the parties filed a Joint Statement on Contested Matters. IDOR again took the position that the Trustee had waived the right to bring an action for equitable subordination unless a motion was promptly filed. *See* Joint Statement on Contested Matters

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[35] Because the Court found that Chandler did not owe the tax and that even if Chandler owed the tax, the Debtor did not willfully fail to pay it, the Court need not address the issue of equitable subordination. However, in the interest of completing the record, and because the issue was directly raised and remanded by the District Court in its opinion for possible determination, the Court will discuss the issue. *See Stoecker*, 179 B.R. at 539, 544.

at 8. On March 21, 1996, the Trustee presented the instant motion for summary judgment in which he seeks entry of a judgment against IDOR equitably subordinating its claim. The Trustee has not filed a separate motion seeking equitable subordination. Consequently, IDOR contends that the issue of equitable subordination of its claim is not properly before the Court.

Procedurally, the Court notes that to the extent the Trustee has alleged that IDOR's claim should be equitably subordinated, he must normally file an adversary proceeding. *See* Fed.R.Bankr.P. 7001(8). However, a party may waive its right to object to the other party's failure to file an adversary proceeding. *See In re Pence*, 905 F.2d 1107, 1109 (7th Cir.1990). IDOR agreed to waive the formal requirement of filing an adversary proceeding provided the Trustee file a motion seeking such relief. The Trustee subsequently filed the instant motion for summary judgment, in which, among other things, he requested that IDOR's claim be subordinated. IDOR has, therefore, waived its right to object.

The Court finds that this motion is sufficient to raise the issue of equitable subordination of IDOR's claim before the Court. Moreover, the District Court's remand requires the Court to consider the issue of whether or not IDOR's claim should be equitably subordinated.[36] Thus,

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[36] Specifically, the District Court stated that "[w]e remand this case to the bankruptcy court to consider whether [IDOR's] late filed claim should be subordinated under the principles of equitable subordination." *See Stoecker*, 179 B.R. at 539. Further, the District Court noted in its Supplemental Memorandum Opinion "[i]f the Bankruptcy Court allows the claim, then it

although the Court agrees that equitable subordination is technically not properly before this Court because the Trustee failed to file an adversary proceeding pursuant to Bankruptcy Rule 7001(8), the Court finds that IDOR has effectively waived such procedural formality and the Court may hear the issue.

2. *Applicable Statute and Case Law Regarding Equitable Subordination*

The doctrine of equitable subordination recognizes the bankruptcy court's fundamental role as a court of equity, and permits the court to disallow or subordinate claims which, if recognized, would produce unjust results. *Pepper v. Litton*, 308 U.S. 295, 304-06, 60 S.Ct. 238, 244-45, 84 L.Ed. 281 (1939); *In re Virtual Network Servs. Corp.*, 902 F.2d 1246, 1248 (7th Cir.1990); *De'Medici v. Salson Express Co. (In re Lifschultz Fast Freight)*, 191 B.R. 712, 714 (N.D.Ill.1996). The doctrine is codified at 11 U.S.C. § 510(c), which provides in relevant part:

> (c) Notwithstanding subsections (a) and (b) of this section, after notice and hearing, the court may –
>
> > (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest. . . .

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must determine whether the claim should be equitably subordinated in accordance with this court's August 30, 1994 Memorandum Opinion and Order." *Id.* at 544.

11 U.S.C. § 510(c). The Seventh Circuit set forth three elements that a court should consider in deciding whether to equitably subordinate a claim: (1) whether the creditor engaged in misconduct; (2) whether that misconduct resulted in injury to other creditors or an unfair advantage to the miscreant; and (3) whether subordination of the debt would be inconsistent with other provisions of the Bankruptcy Code. *In re Vitreous Steel Prods. Co.*, 911 F.2d 1223, 1237 (7th Cir.1990).

Recently, the United States Supreme Court rendered its decision in *United States v. Noland*, ___ U.S. ___, 116 S.Ct. 1524, 134 L.Ed.2d 748 (1996). In *Noland*, the Supreme Court held that bankruptcy courts do not have the power to categorically subordinate the government's claim for a post-petition noncompensatory tax penalty, which is entitled under the Bankruptcy Code to priority distribution, in derogation of Congress's scheme of priorities, in the absence of inequitable conduct by the government. *Id.* at ___, 116 S.Ct. at 1528. Specifically, the Court found the categorical reordering of priorities that takes place at the legislative level of consideration is beyond the scope of judicial authority to order equitable subordination under § 510(c). *Id.* at ___, 116 S.Ct. at 1528 ("Congress could have, but did not deny noncompensatory, postpetition tax penalties the first priority given to other administrative expenses, and bankruptcy courts may not take it upon themselves to make that categorical determination under the guise of equitable subordination."). *See United States v. Reorganized CF & I Fabricators of Utah, Inc.*, ___ U.S. ___, 116 S.Ct. 2106, 135 L.Ed.2d 506 (1996) (discusses *Noland*).

The *Noland* case expressly declined to decide "whether a bankruptcy court must always find creditor misconduct before a claim may be equitably subordinated." ___ U.S. at ___, 116 S.Ct. at 1528. Nevertheless, the Seventh Circuit has repeatedly held that misconduct is not necessarily required to subordinate a claim. *Virtual Network*, 902 F.2d at 1250 ("§ 510(c)(1) authorizes courts to equitably subordinate claims to other claims . . . without requiring in every instance inequitable conduct on the part of the creditor claiming parity among other unsecured general creditors."); *see also In re Envirodyne Indus., Inc.*, 79 F.3d 579, 581 (7th Cir.1996) (citing *Virtual Network*), *cert. denied*, ___ U.S. ___, 117 S.Ct. 77, 136 L.Ed.2d 36 (1996). The inquiry to be made is on a case by case basis, while focusing on the fairness to all creditors involved. *See Vitreous Steel*, 911 F.2d at 1237; *Schwab v. Aetna Bank (McDonald Creek Development Co.)*, 1996 WL 139396 (N.D.Ill. March 20, 1996) (citing *Virtual Network*).

IDOR contends that *Noland* effectively overrules *Virtual Network* and *Envirodyne*. The Court rejects IDOR's view that these cases are overruled by the *Noland* decision. *Noland* explicitly declined to address the issue of whether misconduct by the creditor was required to subordinate a claim. ___ U.S. at ___, 116 S.Ct. at 1528. The *Noland* case instead stands for the proposition that a bankruptcy court cannot categorically subordinate claims to reorder the legislative policy embodied in the various provisions established under the Bankruptcy Code.

3. *The Evidence Does Not Mandate Equitable Subordination of IDOR's Claim*

The Trustee maintains that IDOR's claim should be equitably subordinated because it violated the automatic stay on the three instances discussed above. The Trustee concludes that the facts in this case, including IDOR's alleged repeated violations of the automatic stay, coupled with its dilatory conduct in filing its claim, merit equitable subordination.

IDOR contends that its claim should not be equitably subordinated because it did not violate the automatic stay. As the Court previously discussed, the actions taken by IDOR against the Debtor were not in violation of the automatic stay. Consequently, the Trustee's argument for equitable subordination on this basis lacks merit and is rejected. The Court is further obliged to follow the law of the case, as found by the District Court, that the tardiness in the filing of IDOR's claim at bar is not ipso facto grounds for its disallowance. *See Stoecker*, 179 B.R. at 538-39.

Based upon the evidence presented and the above cited case law, the Court finds that IDOR's claim should not be equitable subordinated pursuant to § 510(c). IDOR has admitted it had knowledge of the Debtor's bankruptcy case shortly after it was filed in February 1989; IDOR timely filed other claims in the case; and IDOR, including the audit and collection employees who were investigating the Aircraft purchase, knew that the Debtor was the president and a potential responsible officer of Chandler before the June 26, 1990 claims bar date. *See Stoecker*, 151 B.R. at 997. IDOR, with such knowledge of

the Debtor's bankruptcy case, did not file its proof of claim for the taxes at issue until January 21, 1992, one-and one-half years after the claims bar date. It was not until February 1990, one and one-half years after the sale of the Aircraft, but within the time fixed by the Court for filing proofs of claim, an IDOR revenue auditor began investigating the sale from Prewitt Leasing to Chandler. (Tr. (Russell) 52).

The mere fact that IDOR failed to exercise due diligence in filing its claim does not, in and of itself, serve as a proper basis for equitable subordination in light of the District Court's decision. Whether IDOR filed its claim one day after the bar date or one and one-half years after the bar date, the result is the same – the claim was tardy.

The Court finds that the failure of IDOR's auditor, field collector, and employees of the NPL unit to discover the connection between the liability assessed against Chandler and the penalty assessed against the Debtor was caused principally by Chandler's failure to register the Aircraft with the Illinois Department of Transportation's Division of Aeronautics in 1988 as required by Ill.Rev.Stat., ch. 15 1/2 , ¶ 22.42 (1989). Pursuant thereto, Chandler would have been required to show that the use tax was paid or that the purchase was exempt upon registering the Aircraft as leased in Illinois. The evidence supports a finding that IDOR's failure to timely file the instant claim by the bar date was not intentional or deliberate. Consequently, the Trustee's request for equitable subordination is hereby denied.

V. CONCLUSION

For the foregoing reasons, the Court hereby partially grants the Trustee's motion for summary judgment. The Court holds that Chandler did not owe a use tax. The Court further holds that even if Chandler owed the use tax, IDOR has failed to prove that the Debtor willfully failed to pay it. The Trustee's objection to IDOR's claim is, in part, sustained and the claim is disallowed. However, if IDOR held a valid claim against the Debtor, the Court would not equitably subordinate IDOR's claim under 11 U.S.C. § 510(c) in the circumstances of this case.

This Opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate order shall be entered pursuant to Federal Rule of Bankruptcy Procedure 9021.

ORDER

For the reasons set forth in a Memorandum Opinion dated October 17, 1996, the Court hereby partially grants the motion of Thomas E. Raleigh, the Chapter 7 trustee, for summary judgment. The objection of Thomas E. Raleigh to the Illinois Department of Revenue's claim is sustained in part and the claim is disallowed. The Court holds that Chandler Enterprises, Inc. did not owe a use tax assessed against it by the Illinois Department of Revenue. Even if Chandler owed the use tax, the Court further holds that the Illinois Department of Revenue has failed to prove that the Debtor, William J. Stoecker, willfully failed to pay the tax. Finally, if the Illinois Department of

Revenue held a valid claim against the Debtor, the Court would not equitably subordinate the claim under 11 U.S.C. § 510(c).

APPENDIX D

In re William J. STOECKER, Debtor.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE, Appellant,

v.

Thomas E. RALEIGH as Trustee of the Estate of William J. Stoecker, Appellee.

Nos. 93 C 2160, 89 B 2873.

United States District Court, N.D. Illinois, Eastern Division.

Aug. 31, 1994.

Opinion Granting Rehearing and Denying Certification for Appeal March 23, 1995.

James Douglas Newbold, Illinois Atty. General's Office, Chicago, IL, for Etolen and Buchanan Masonry, State of Ill., Dept. of Revenue.

Robert Radasevich, David A. Eide, George Michael Hoffman, Neal, Gerber & Eisenberg, Chicago, IL, for Thomas E. Raleigh.

Thomas E. Raleigh, Raleigh and Helms, Chicago, IL, for William J. Stoecker.

MEMORANDUM OPINION AND ORDER

ANDERSEN, District Judge.

This case is before the court on the appeal of the State of Illinois Department of Revenue ("Department") from the United States Bankruptcy Court for the Northern District of Illinois. *In re Stoecker,* 151 B.R. 989

(Bankr.N.D.Ill.1993) (Squires, J., presiding). The principal issue in this case is whether Rule 3002 of the Federal Rules of Bankruptcy Procedure ("Rule ___") acts as a bar date to exclude late filed priority claims in a Chapter 7 case. The court holds that Rule 3002 does not bar late filed priority claims. In addition, the court concludes that principles of equitable subordination should determine whether late filed priority claims are entitled to distribution, and if so, the particular distribution level they are entitled to under 11 U.S.C. § 726. For the following reasons, the bankruptcy court's decision is reversed and remanded for further proceedings in accordance with this opinion.

BACKGROUND

This case began as an involuntary Chapter 11 petition against William J. Stoecker ("Debtor") and was converted to Chapter 7 on February 26, 1990. Thomas E. Raleigh ("Trustee") was appointed the Chapter 11 trustee of the Debtor's estate and was reappointed as the Chapter 7 trustee. Pursuant to 11 U.S.C. § 341(a), a meeting of creditors was held on March 28, 1990. As required by Rule 3002(c), all proofs of claim were to be filed on or before June 26, 1990 ("the bar date"), ninety days after the meeting. On July 25, 1989, the Department timely filed three proofs of claim totalling $14,852.03.

Prior to the above proceedings, the Debtor had purchased an aircraft from Prewitt Leasing, Inc. ("Prewitt") on September 30, 1988. At that time, he was president and sole director of Chandler Enterprises, Inc. ("Chandler").

Chandler subsequently leased the aircraft to Grabill Corporation ("Grabill"), a corporation in which the Debtor was president and sole shareholder. Neither Chandler nor Prewitt paid any sales/use tax, withholding tax, or income tax on Chandler's purchase of the aircraft. The Debtor states that his attorney advised him that there was no sale or use tax properly assessable or payable as a result of the purchase by Chandler or the lease of the aircraft by Chandler to Grabill. Chandler was involuntarily dissolved by the Illinois Secretary of State on June 1, 1990.

After the Department received notice of the Debtor's bankruptcy filing, the Department researched his liability to the Department. Apparently due to Chandler's failure to register with the Department and to file any tax returns, the Department did not determine that the Debtor was an officer of Chandler during this initial search. Nevertheless, in approximately February, 1990, the Department conducted a separate investigation into the records of the Federal Aviation Administration. At that time, the Department learned of Chandler's purchase of the aircraft. The Department wrote two letters to Chandler dated March 7, 1990 and June 7, 1990 seeking additional information in order to ascertain whether the purchase of the airplane was subject to use tax. Chandler did not respond to either letter.

On September 7, 1990, the Department issued a Notice of Penalty Liability against Chandler. Between September 26, 1991 and April 9, 1991, the Department attempted to contact Chandler and its officers but was unsuccessful. Subsequently, a Notice of Penalty Liability was issued against the Debtor on August 15, 1991. The

Department sent the Debtor a demand for full payment of the tax liability claimed on September 25, 1991. On January 21, 1992, approximately 18 months after the bar date, the Department filed a proof of claim in the amount of $1,476,196.86 for Retailers' Occupation/Use Tax allegedly owed by the Debtor as the responsible officer of Chandler.

The Trustee objected to the January 21, 1992 proof of claim filing because it was filed after the bar date fixed by Rule 3002(c). In addition, the Trustee also argued that the Debtor is not liable for the use tax under the "occasional sale" exemption.

In the bankruptcy court, the Department argued that the court should allow the claim as an amendment to the earlier filed proofs of claim pursuant to Fed.R.Civ.P. 15. In the alternative, the Department asked the bankruptcy court to use its equitable powers to allow the claim.

In its Memorandum, Opinion, and Order dated November 25, 1992, the bankruptcy court sustained the Trustee's objection and did not allow the Department's claim. It found that the Department's proof of claim was tardily filed. The court reasoned that the claim was an entirely new claim, and not an amendment to an earlier filed claim. Accordingly, the amendment was barred by Rule 3002(c). Furthermore, the court declined to allow the claim under its equitable powers.

The Department filed a motion for reconsideration of the bankruptcy court's decision to sustain the Trustee's objection on December 10, 1992. The motion was based in part on the *In re Rago*, 149 B.R. 882 (Bankr.N.D.Ill.1992)

case, which was decided two days prior the court's original ruling, and reached a contrary result. The court denied the motion for reconsideration on February 23, 1993.

The Department now appeals the bankruptcy court's decision. This action was a core proceeding before the bankruptcy court under 28 U.S.C. § 157(b)(2)(B). This court has jurisdiction pursuant to 28 U.S.C. § 158(a).

DISCUSSION

Rule 8013 provides that a district court must accept the bankruptcy court's findings of fact unless clearly erroneous. Fed.R.Bankr.P. 8013; *In re Tolona Pizza Prod. Corp.*, 3 F.3d 1029, 1033 (7th Cir.1993). However, the court may independently examine the bankruptcy court's conclusions of law. *In re Yonikus*, 996 F.2d 866, 868 (7th Cir.1993). Accordingly, this court subjects the bankruptcy court's conclusions of law to *de novo* review. *In re UNR Indus., Inc.*, 986 F.2d 207, 208 (7th Cir.1993).

I. *Preliminary Issue*

The court must first determine whether the Department improperly raised new matters before the bankruptcy court in its motion for reconsideration. The Trustee contends that the Department improperly used its motion to argue for the first time that untimeliness can never constitute a proper basis for disallowance of a proof of claim. This theory was espoused by Bankruptcy Judge Wedoff in *In re Rago*.

The Trustee cites *Publishers Resource, Inc. v. Walker-Davis Publications, Inc.*, 762 F.2d 557 (7th Cir.1985), to support the proposition that motions to reconsider serve "to correct manifest errors of law or fact or to present newly discovered evidence." *Publishers Resource*, 762 F.2d at 561 (citing *Keene Corp. v. Int'l Fidelity Ins. Co.*, 561 F.Supp. 656, 665-66 (N.D.Ill.1982), *aff'd*, 736 F.2d 388 (7th Cir.1984)). Moreover, such motions should not "serve as the occasion to tender new legal theories for the first time." *Id.* The Trustee also cites *Havoco of America, Ltd. v. Sumitomo Corp. of America*, 971 F.2d 1332, 1336 (7th Cir.1992) for the broad proposition that a legal argument raised for the first time on a motion for reconsideration is waived if not presented before judgment was entered.

In response, the Department argues that *In re Rago* represents a significant development in the law pertaining to the area of allowances. Furthermore, the Department subsequently brought to our attention *In re Vecchio*, 20 F.3d 555 (2nd Cir.1994) which adopted the rationale of *In re Rago* and was decided after the court denied the motion for reconsideration. The bankruptcy court in the case at hand relied heavily on *United States v. Vecchio*, 147 B.R. 303 (E.D.N.Y.1992), the decision that *In re Vecchio* explicitly reversed. *In re Vecchio* at 556. It is also significant to note that the author, Judge Wedoff, of *In re Chirillo*, 84 B.R. 120 (Bankr.N.D.Ill.1988), a case cited with approval by the bankruptcy court in this case, later rejected *Chirillo* by stating that the case was based on the mistaken assumption that a late filed claim is disallowed. *In re Rago*, 149 B.R. at 885.

In light of these developments, this court holds that the Department's new argument is properly before the

court on appeal. Both *In re Rago* and *In re Vecchio* represent highly persuasive authority that the Department could not have presented to the bankruptcy court before it delivered its opinion.

Furthermore, the court does not read the *Havoco* decision as broadly as the Trustee. In that case, the court simply held that a Fed.R.Civ.P. 59(e) motion to alter or amend the judgment "cannot be used to raise new arguments which could and should have been raised before judgment was entered." *Havoco*, 971 F.2d 1332 at 1336. The Trustee correctly points out that, before the bankruptcy court entered judgment in this case, limited authority was available to the Department to support the theory it now advances. However, this court can not conclude that a reasonable litigant in the Department's position should have raised the new argument prior to the bankruptcy court's decision, particularly when it could not have known about *In re Rago* or *In re Vecchio*.

Therefore, the court holds that the Department's new argument is properly before the court on appeal.

II. *Interrelation of Rule 3002 and 11 U.S.C. §§ 501, 502 and 726*

The principal issue in this case is whether Rule 3002 acts as a bar date to exclude late filed priority claims in a Chapter 7 proceeding. That rule provides in pertinent part:

> (a) NECESSITY FOR FILING. An unsecured creditor or an equity security holder must file a proof of claim or interest in accordance with this rule for the claim or interest to be allowed. . . .

> (c) TIME FOR FILING. In a chapter 7 liquidation . . . a proof of claim shall be filed within 90 days after the first date set for the meeting of creditors called pursuant to § 341(a) of the Code. . . .

Fed.R.Bank.P. 3002. There are also several code provisions dealing with the filing and allowance of proofs of claim, and distribution of property of the estate. Section 501(a) states that "[a] creditor . . . may file a proof of claim." 11 U.S.C. § 501(a). Section 502(a) then explains that, "[a] claim . . . , proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest . . . objects." 11 U.S.C. § 502(a). Section 502(b) lists eight categories upon which a party in interest can base its objection. Of particular significance is the provision allowing a party to object if the claim is unenforceable under "applicable law." 11 U.S.C. § 502(b)(1).

Finally, § 726 describes the distribution of property of the estate:

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed –
>
> (1) first, in payment of claims of the kind specified in, and in the order specified in, section 507 of this title;
>
> (2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is –
>
> (A) timely filed under section 501(a) of this title;
>
> (B) timely filed under section 501(b) or 501(c) of this title; or

> (C) tardily filed under section 501(a) of this title, if –
>
> (i) the creditor that holds such a claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and
>
> (ii) proof of such claim is filed in time to permit payment of such claim;
>
> (3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title other than a claim of the kind specified in paragraph (2)(C) of this subsection;
>
> (4) fourth, in payment of any allowed claim, whether secured or unsecured, for any fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, arising before the earlier of the order for relief or the appointment of a trustee, to the extent that such fine, penalty, forfeiture, or damages are not compensation for actual pecuniary loss suffered by the holder of such claim;
>
> (5) fifth, in payment of interest at the legal rate form the date of the filing of the petition, on any claim paid under paragraph (1), (2), (3), or (4) of this subsection; and
>
> (6) sixth, to the debtor.

11 U.S.C. § 726.

The Department argues that because these code sections are in conflict with Rule 3002, the code provisions should prevail. *U.S. v. Cardinal Mine Supply, Inc.*, 916 F.2d

1087, 1089-90 (6th Cir.1990). According to the Department, a conflict exists because Rule 3002 makes it clear that for a proof of claim to be allowed it must be filed within 90 days after the date set for the meeting of creditors. In contrast, § 501 contains no prohibition on the filing of claims after the bar date and § 502 states that a claim is allowed assuming the absence of a valid objection. None of the categories listed in § 502(b) upon which a party can base an objection explicitly includes the late filing of a claim. The Department emphasizes that §§ 726(a)(2)(C) and 726(a)(3) explicitly provide for "allowed claims, proof of which is *tardily* filed." (emphasis added). This approach was advanced by the recent *In re Rago* case.

The bankruptcy court rejected this argument and did not find that Rule 3002 was in conflict with the code. *In re Stoecker*, 151 B.R. at 995. The court stated that § 502(b)(1) provides for disallowance of a claim that is unenforceable under applicable law and that Rule 3002(c) constitutes applicable law. *Id.* Therefore, the court concluded that § 502(b)(1) disallows a claim not filed pursuant to Rule 3002(c) when a party in interest raises an objection to the claim. *Id.*

According to the Department, this rationale is flawed because there is still a conflict between Rule 3002 and § 726(a). In its opinion denying the motion for reconsideration, the bankruptcy court addressed this problem. It noted that, during those infrequent situations when there are sufficient funds available to fully pay all claims that were both timely and tardily filed, the trustee would not need to file an objection to late filed claims. The court stated that in these cases there is no need for a trustee to

object to late filed claims because there are enough funds to pay all claims.

In response, the Department argues that the bankruptcy court's reasoning is flawed for three reasons. First, it assumes that a claim which is untimely filed under Rule 3002 is allowed under § 502(a) unless the trustee objects to it. However, Rule 3002 explicitly states that a claim not filed in conformity with it is not allowed. Second, the court's position also assumes that a late filed claim is only disallowed if the trustee files an objection. If the trustee does not object, the claim is allowed. Third, the court's conclusion is subject to abuse because § 502(a) allows any party in interest to object. Thus, a creditor with a timely but subordinated claim would always object to a late filed claim to increase its distribution. A debtor who is entitled to all funds left over after payment of allowed claims would also object to late claims for the same reason.

The Department urges the court to reject the position taken by courts in cases exemplified by *In re Zimmerman*, 156 B.R. 192 (Bankr.W.D.Mich.1993) (en banc). *In re Zimmerman* was a Chapter 13 case and described two types of allowance of claims: 1) procedural allowance under § 501 which looks to Rule 3002 to establish time limits and 2) substantive allowance pursuant to § 502 where a claim is considered on the merits. *Id.* at 198. According to this analysis, a claim is deemed filed under § 501(a) only if it is filed within the time limits set by Rule 3002. *Id.* If the claim is filed late it is not allowed, and § 502 never comes into play. *Id.; see also In re Johnson*, 156 B.R. 557 (Bankr.N.D.Ill.1993). The Trustee attempts to extend this rationale to resolve the conflict between Rule 3002 and

§§ 726(a)(2)(C) and 726(a)(3). It asserts that the § 726 provisions provide only for distribution of claims allowed on the merits under § 502.

Not surprisingly, the Trustee relies heavily on *In re Zimmerman* to support his position that tardiness is a ground for disallowance of a claim under § 502. That case recognized that § 501(c) contemplates a timeliness requirement: "If a creditor does not *timely* file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim." (emphasis added). *In re Zimmerman*, 156 B.R. at 195-96. It also noted that legislative history indicates that Congress intended for the Bankruptcy Rules to contain the procedural aspects of bankruptcy practice. *Id.* at 197.

The Trustee next tries to explain why the "tardily filed" language exists in §§ 726(a)(2)(C) and 726(a)(3). It states that it is appropriate for the provisions to contain this language to distinguish substantively meritorious claims from substantively infirm ones. Further, it contends that *In re Rago* does not apply here because that case involved a late filed original claim, whereas the Department has maintained throughout that its claim is an amendment of a previously filed timely claim. *See In re Unroe*, 937 F.2d 346 (7th Cir.1991).

This court holds that Rule 3002 does not act as a bar date to exclude late filed priority claims in a Chapter 7 case. The decision in *In re Vecchio*, 20 F.3d 555 (2nd Cir.1994) is particularly persuasive. It stated that, "to the extent Rule 3002 suggests that a late filed claim must be disallowed, it is inconsistent with the text of §§ 726, 502, and 501." *In re Vecchio*, at 559; *Cardinal Mine*, 916 F.2d at

1089. The court observed that § 501 does not impose a timeliness requirement. *In re Vecchio*, at 559. Similarly, not only is there no requirement in § 726(a) that allowance of a claim requires a timely filing, but §§ 726(a)(2)(C) and 726(a)(3) expressly order the payment of such claims. *Id.* at 558. Furthermore, untimeliness is not listed as a grounds for disallowance under § 502. *Id.* at 558-59. This court rejects the Trustee's notion that the "tardily filed" language was inserted in these provisions to remove substantively infirm claims from distribution. There is no logical reason for Congress to provide an entire list of grounds for disallowance in one provision entitled "Allowance of claims or interests," while inserting another ground for disallowance in a separate provision entitled "Distribution of property of the estate."

Accordingly, this court can only conclude that *In re Hausladen*, 146 B.R. 557, 559 (Bankr.D.Minn.1992) was correct when it stated that Rule 3002's erroneous implication that filing within the prescribed period is a prerequisite to allowance "arose when the drafters of the new Rule 3002 hastefully copied the substance of *old* Rule 302 without paying any attention to the major change in the underlying statute." (emphasis in original). *See also In re Rago*, 149 B.R. at 885. Section 726 does not bar tardily filed claims. *In re Vecchio*, at 559 (citing *Cardinal Mine*, 916 F.2d at 1091).

Since *In re Zimmerman* is a Chapter 13 case, the court will not apply it here. Unlike Chapter 13 cases where payments are distributed under a plan, § 726 provides for the order of distribution of property of the estate in Chapter 7 cases. Even if *In re Zimmerman* resolves the conflict between Rule 3002 and §§ 501 and 502, it simply

can not resolve the conflict between Rule 3002 and §§ 726(a)(2)(C) and 726(a)(3). Therefore, the court will not apply the reasoning of *In re Zimmerman* to this Chapter 7 case.

Moreover, the court in *In re Vecchio* saw no relevance to the fact that the Internal Revenue Service in that case filed amended claims of a previously filed timely claim, as opposed to a late filed original claim. Since the facts in this case are similar, the court does not believe it is necessary to decide whether the Department filed an amended or original claim. Additionally, the court agrees with the Department that the other cases the Trustee cites in support of its argument, i.e., *Wilkens v. Simon Brothers, Inc.*, 731 F.2d 462 (7th Cir.1984), *In re Danielson*, 981 F.2d 296 (7th Cir.1992), and *Holstein v. Brill*, 987 F.2d 1268 (7th Cir.1993) do not address the specific issue in this case.

We disagree with the decisions in other jurisdictions which have subordinated first-tier priority claims to the third-tier of distribution as non-priority claims based on the tardiness of their filing. *See IRS v. Ulrich (In re Mantz)*, 151 B.R. 928, 930-31 (9th Cir. BAP 1993); *In re Elec. Management, Inc.*, 133 B.R. 90, 92 (Bankr.N.D.Ohio 1991); *In re Mayville Feed & Grain, Inc.*, 123 B.R. 245, 246-47 (Bankr.E.D.Mich.1991). As stated in *In re Vecchio*:

> These courts have also read a timeliness requirement into § 726(a)(1) despite the absence of such language in that provision or in others in the Code, and have failed to address the inconsistencies that arise as a result of their narrow reading of § 726(a)(1) to exclude late filed priority claims, their broad reading of § 726(a)(3) to include late filed priority claims, and their construction of Rule 3002 to permit subordination and not disallowance of such claims.

20 F.3d at 559.

Nevertheless, the court differs with the Department's contention that priority claims, regardless of when they are filed, are automatically entitled to receive a first level distribution pursuant to § 726(a)(1). The court agrees with *In re Rago* that such a rule would not encourage finality in the administration of claims. *In re Rago*, 149 B.R. at 888 (citing *In re Evanston Motor Co.*, 26 B.R. 998, 1005 (N.D.Ill.1983)). This concern is particularly valid when claimants deliberately or negligently fail to file their claims within the time limit established by the Bankruptcy Rules. *Id.*

Therefore, the court concludes that bankruptcy courts should use principles of equitable subordination when dealing with late filed priority claims. *Id.* at 889-90; *In re Vecchio*, at 560; *see also In re Virtual Network Serv. Corp.*, 902 F.2d 1246 (7th Cir. 1990). As discussed in *In re Rago*, 149 B.R. at 889-90, § 726(a) provides that property of the estate shall be distributed "[e]xcept as provided in section 510 of this title." Section 510(c)(1) provides that "after notice and a hearing, the court may . . . under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim." As stated in *In re Rago*:

> Where, despite adequate notice or knowledge of the bankruptcy, a priority creditor fails to file a timely proof of claim, it may be equitable to subordinate the creditor's claim to claims that

> were timely filed. Since general considerations of fairness will support subordination even without inequitable conduct on the part of the creditor, an unexcused delay by the creditor in filing a proof claim certainly provides a basis to subordinate. Moreover, based on general considerations of fairness, it may be equitable to subordinate a late filed priority claim even where the creditor lacked adequate notice or knowledge, if a distribution has already taken place and an undoing of the distribution would be excessively burdensome. In either situation, the notice and hearing provision of Section 510(c) will assure that the priority creditor can present the arguments against subordination to the court.

Id. at 890.

The court believes that the reasoning in *In re Rago* fairly and appropriately balances the interests of all parties in these types of cases. Particularly when a priority claim is filed after disbursement of an estate, courts should carefully weigh the benefits and burdens of all parties to reach a just and equitable result. *In re Vecchio*, at 560.

CONCLUSION

For the forgoing reasons, the decision of the bankruptcy court ruling that § 11 U.S.C. 502(b)(1) disallows a claim not filed pursuant to Rule 3002(c) is reversed. We remand this case to the bankruptcy court to consider whether the Department's late filed claim should be subordinated under the principles of equitable subordination.

SUPPLEMENTAL MEMORANDUM, OPINION AND ORDER

Thomas E. Raleigh, Chapter 7 Bankruptcy Trustee (the "Trustee") in the Estate of William J. Stoecker (the "Debtor") has moved for a rehearing of this Court's August 30, 1994 Memorandum, Opinion and Order (the "Opinion") pursuant to Fed.R.Bank.P. 8015. Additionally, the Trustee moves this court for certification for interlocutory appeal pursuant to 28 U.S.C. § 1292(b). In the Opinion, this court reversed the Bankruptcy Court's decision which had disallowed a priority tax claim asserted by the State of Illinois Department of Revenue (the "Department") against the Debtor because the proof of claim was untimely filed. The Opinion remanded the case to the Bankruptcy Court to determine whether the Department's tardily filed claim should be equitably subordinated.

In its current motion, the Trustee correctly points out that the Opinion failed to address the second issue presented in the appeal, namely, the Bankruptcy Court's substantive disallowance of the claim on the merits. Specifically, the Bankruptcy Court disallowed the claim because the Department had failed to establish that the Debtor, as a responsible officer of the non-debtor corporation, Chandler Enterprises, Inc. ("Chandler"), had wilfully failed to pay the use tax assessed against Chandler.

For the following reasons, this court grants the motion for rehearing to review whether the claim should have been disallowed on the merits, reverses the Bankruptcy Court's decision to disallow the claim, remands

the matter for a new hearing and/or evaluation of the evidence, and denies the motion for certification.

STANDARD OF REVIEW

Federal Rule of Bankruptcy 8015, which governs motions for rehearing, is silent as to the appropriate standards for granting such relief. However, because Fed.R.Bank.P. 8015 was derived from Fed.R.App.P. 40, it is appropriate to look to the appellate rule for guidance. 9 Collier on Bankruptcy 8015.04 at 6015-4 (15th ed. 1993). Federal Rule of Appellate Procedure 40 provides in part, "[t]he petition must state with particularity the points of law of fact which in the opinion of the petitioner the court has overlooked or misapprehended. . . . " Accordingly, this motion for rehearing is properly before this court.

DISCUSSION

When deciding an appeal from a bankruptcy court, a district court must accept the bankruptcy court's findings of fact unless they are clearly erroneous. *In re Evanston Motor Co.*, 735 F.2d 1029, 1031 (7th Cir.1984); *In re Robinson*, 169 B.R. 171, 174 (N.D.Ill.1994). But "where there are pure questions of law or mixed questions of law and fact, the District Court may conduct a de novo review." *In re Mader*, 108 B.R. 643, 644 (N.D.Ill.1989). Because the decision below involved mixed law and fact questions, we conduct de novo review.

The Department's claim against Chandler is based on a use tax assessed under section 3 of the Use Tax Act,

Ill.Rev.Stat., ch. 120, para. 439.3 (codified as 35 ILCS 105/3). Section 12 of the Use Tax Act, Ill.Rev.Stat., ch. 120, par. 439.12 (codified as 35 ILCS 105/12), in turn, incorporates by reference section 13½ of the Retailer's Occupation Tax Act ("ROTA"), Ill.Rev.Stat., ch. 120, par. 452½ (1991) (codified as 35 ILCS 120/13.5 (West 1992)). Section 13½ of the ROTA provides that a responsible individual may be liable for taxes under certain circumstances when a corporate taxpayer fails to pay the taxes to the Department. Accordingly, the Department brought the instant claim against the Debtor because Chandler did not pay the assessed use tax. The Department argued that the Debtor was liable for the amount of the tax based on the Debtor's status as a "responsible officer" who wilfully failed to pay the use tax which had been assessed against Chandler pursuant to the Use Tax Act.

Section 13½ of the ROTA provides, in part, as follows:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed . . . and who wilfully fails to file such return or to make such payment to the Department or wilfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon. . . .

35 ILCS 120/13.5. Thus, the statutory language is unambiguous and clearly states that a person responsible for withholding and paying over taxes who wilfully fails to

do so is liable for a penalty equal to the total amount of the unpaid taxes.

Section 13½ of the ROTA also sets forth the method by which the Department establishes the liability against a person who it believes to be a "responsible officer" of a corporation and the method by which the Department proves the liability at a hearing. Section 13½ further provides:

> The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section. Proof of such determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall, without further proof, be admitted into evidence before the Department or any legal proceeding and shall be prima facie proof of the correctness of the penalty due, as shown thereon. The Department shall in every case issue a notice of penalty liability for the amount claimed by the Department pursuant to this Section. Procedures for protest and review of a notice of penalty liability issued pursuant to this Section and assessment of the penalty due hereunder shall be the same as those prescribed for protest and review of a notice of tax liability and the assessment of tax liability under this Act as set forth in Sections 5 and 12 of this Act [35 ILCS 120/5 and 35 ILCS 120/12].

35 ILCS 120/13.5.

On August 15, 1991, the Department issued its Notice of Penalty Liability ("NPL") against the Debtor for the outstanding use taxes which it had previously assessed against Chandler by issuance of its NPL against Chandler on September 9, 1990. The liability established by the issuance of the NPL was the basis of the claim against the Debtor.

In the bankruptcy proceeding, the Trustee asserted that Chandler was not liable for the use tax on its purchase of the aircraft and, therefore, the Debtor could have no liability as a "responsible officer" of Chandler. The Trustee claimed that Chandler's purchase of the aircraft from Prewitt Leasing was an "occasional sale" exempt from use tax because Prewitt Leasing was not a "retailer." In its reply, the Department took the position that the Bankruptcy Court lacked jurisdiction to decide the tax liability of Chandler as a non-debtor whose liability had already been determined under state law. In addition, the Department denied that the sale was exempt from use tax.

At trial, the Department submitted into evidence, under certificate of the Director of the Department of Revenue, the NPL issued against the Debtor. In support of its position that the purchase of the aircraft was an occasional sale exempt from use tax and that the Debtor had no liability as a responsible officer of Chandler, the Trustee presented the testimony of John Anderson. Mr. Anderson was the attorney who had represented Chandler with respect to the purchase of the aircraft. He testified that he had issued an opinion letter to the financing company concluding that, under Illinois law,

there was no sale or use tax properly assessable or payable as a result of the purchase of the aircraft by Chandler or the lease of the aircraft by Chandler to Grabill. This opinion was supported by the Vice-President of Prewitt Leasing, Inc. who signed a "Certificate Re Occasional Seller Exemption from Illinois Sales and Use Tax" on September 30, 1988. However, he testified that he never issued such an opinion letter to Chandler or any of its officers.

As a preliminary matter, the Bankruptcy Court properly found that it had jurisdiction to determine the tax liability of a non-debtor entity such as Chandler pursuant to the plain language of 11 U.S.C. § 505(a)(1). *In re Stoecker*, 151 B.R. 989, 998-99 (Bankr.N.D.Ill.1992). Pursuant to 11 U.S.C. § 505(a)(1), the court is authorized to "determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." 11 U.S.C. § 505(a)(1). In addition, the Bankruptcy Court relied on several decisions which held that a bankruptcy court may apply section 505(a) to determine the tax liability of parties other than the debtor. *In re Stoecker*, 151 B.R. at 998-99 (citing *In re Wolverine Radio Co.*, 930 F.2d 1132 (6th Cir.1991); *In re Goldblatt Bros.*, 106 B.R. 522 (N.D.Ill.1989); *In re Major Dynamics, Inc.*, 14 B.R. 969 (S.D.Cal.1981)). On remand, if the Bankruptcy Court finds that the Debtor wilfully failed to pay the use tax assessed against Chandler, the Court must also make the finding that Chandler owed the assessed tax.

The Bankruptcy Court then found that, as president and sole director of Chandler, the Debtor was in control of Chandler. *Stoecker*, 151 B.R. at 1000. Next, the court found that the Department had established a prima facie case by introducing a copy of the NPL issued against the Debtor but that, based on the testimony of Trustee's witness, John Anderson, the burden had shifted back to the Department. The court went on to hold "that the Department ha[d] failed to meet its burden and establish that the Debtor wilfully failed to pay the tax assessed against Chandler for the sale of the aircraft." *Id.* at 1000.

Based principally on the decisions in *Department of Revenue v. Heartland Invest., Inc.*, 106 Ill.2d 19, 86 Ill.Dec. 912, 476 N.E.2d 413 (1985) and *Department of Revenue v. Corrosion Systems, Inc.*, 185 Ill.App.3d 580, 133 Ill.Dec. 647, 541 N.E.2d 858 (4th Dist.1989), the Bankruptcy Court held that in order to establish the element of wilfulness, the Department was required to show a voluntary, conscious, intentional or reckless failure of the Debtor to pay the tax. The court found that the Department had introduced no evidence to support a finding of wilfulness under this standard and, therefore, disallowed the claim on the merits. *Stoecker*, 151 B.R. at 1000.

In its motion to reconsider, the Department argued that it had established its prima facie case of liability against the Debtor by introducing the NPL into evidence and that the burden was thereafter shifted to the Trustee to show a lack of wilfulness. The Bankruptcy Court rejected this argument stating:

> Contrary to the Department's arguments, the Department had the burden of proof to show the Debtor's failure to pay the subject claim was

> willful, rather than the Trustee, as the objector, having the burden to show that the Debtor's failure to pay was not willful. No evidence was adduced by the Department to show that the Debtor's failure to pay the claimed tax was a voluntary, conscious and intentional failure. . . .

Stoecker, 151 B.R. at 1006.

Before this court, the Department argues that it established its prima facie case of the Debtor's liability under section 13½ by submitting the NPL sent to the Debtor. Further the Department argues that the Debtor has failed to rebut the presumption of his liability arising from the Department's prima facie case because the Debtor failed to submit any evidence to the contrary. The Trustee contends that, even if this court finds the NPL deserves a presumption of wilfulness, he introduced uncontroverted evidence that the Debtor's failure to pay the alleged tax was not wilful due to the opinion of outside counsel that the transaction was not subject to the use tax.

Two reported Illinois Appellate Court opinions interpret section 13½ of the ROTA in relation to the evidentiary effect of an NPL issued by the Department.[1] The two cases reach contrary conclusions. The Illinois Supreme Court has not decided this issue.

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[1] On January 1, 1994, section 13½ was replaced by section 3-7 of the Uniform Penalty and Interest Act. (Ill.Rev.Stat. ch., 120, sec. 2603- 7) (now codified as 35 ILCS 735/3-7 (West 1992)). Section 13½ stated the NPL "shall be prima facie proof of the correctness of the penalty due." Section 3-7 now states the NPL "shall be prima facie proof of the correctness for the amount of penalty due."

The Trustee urges this court to follow the recent decision in *Griffith v. Department of Revenue,* 266 Ill.App.3d 838, 203 Ill.Dec. 889, 640 N.E.2d 1262 (1st Dist.1994) delivered by Justice Buckley while the Department urges the court to follow the decision in *Branson v. Department of Revenue,* 268 Ill.App.3d 818, 206 Ill.Dec. 140, 644 N.E.2d 1193 (4th Dist.1994) delivered by Justice Steigmann. Both of these cases were decided after the Bankruptcy Court's decision.

In *Griffith,* the Appellate Court interpreted section 13½ of the ROTA as stating that an NPL is prima facie evidence only of the *amount* due and not of the *wilfulness* of a responsible officer. *Griffith,* 203 Ill.Dec. at 892, 640 N.E.2d at 1265 (emphasis added). Therefore, the court declared that the Department bears the burden of introducing additional evidence to prove wilfulness. The court explicitly rejected the Department's argument that a "prima facie case is met simply by admitting into evidence the reproduced copy of [its] records, i.e., the NPL and Corporate Tax Returns." *Id.* Instead, the court reasoned that the language of the statute reads that the Department's records shall only be prima facie evidence of a penalty due and prima facie proof of the correctness of the penalty. The court refused to equate the meaning of "prima facie case" with the phrases "prima facie evidence of a penalty due" and "prima facie proof of the correctness of the penalty due." *Id.* The court concluded that the meanings of these phrases are not the same and that:

> [t]o hold otherwise would require this court to assume that a person acted wilfully every time the Department's records showed a corporate tax liability. This reading would in effect merge

> the element of wilfulness into the element of corporate liability and would render the wilful language [of the statute] superfluous or meaningless.

Id.

We respectfully disagree with the *Griffith* decision and find Justice Steigmann's reasoning in the *Branson* decision to be more persuasive. In *Branson*, the Appellate Court determined that section 13½ of the ROTA does not limit the prima facie proof to the *amount* of the penalty only. *Branson*, 206 Ill.Dec. at 144, 644 N.E.2d at 1197. The court stated that "the statute provides the introduction of [the NPL] establishes prima facie proof of the correctness of its assessment of a penalty against a taxpayer and, without more, *establishes all the elements necessary for the imposition of a penalty against an individual.*" *Id.*, 206 Ill.Dec. at 143, 644 N.E.2d at 1196 (emphasis added). The court reached this conclusion by analyzing other sections of the ROTA as well as an analogous federal statute.

For example, section 4 of the ROTA, which deals with departmental determinations of the amount of tax due in examining and correcting returns, provides that "Such certified reproduced copy . . . shall be prima facie proof of the correctness of the *amount* of tax due, as shown therein." 35 ILCS 120/4 (emphasis added). Therefore, section 4 indicates that the legislature clearly knew how to limit prima facie determinations to amounts only, in contrast to the existence of the penalty itself.

Additionally, the *Branson* court noted that its interpretation of section 13½ of the ROTA agrees with interpretations of similar federal tax statutes. In interpreting

the meaning of section 13½ of the ROTA, it is appropriate to consider the interpretation given section 6672 of the Internal Revenue Code. *Department of Revenue v. Joseph Bublick & Sons*, 68 Ill.2d 568, 12 Ill.Dec. 265, 369 N.E.2d 1279 (1977). Section 6672(a) of the Internal Revenue Code of 1986 provides that a person responsible for withholding and paying over taxes who wilfully fails to do so is liable for a penalty equal to the total amount of the unpaid taxes. 26 U.S.C.A. § 6672(a) (1989).

In *Brounstein v. United States*, 979 F.2d 952, 954 (3d Cir.1992), the court held that an assessment against a responsible person is equivalent to the assessment of a tax and carries with it a rebuttable presumption that it is correct. Significantly, the court further held that "the IRS's introduction of certified copies of the assessment [at the trial level] shifted to [the taxpayer] the burden of going forward with evidence to show that the assessment against him under 6672 was incorrect by establishing either (1) that he was not a responsible person within the meaning of the statute, or (2) that he did not wilfully fail to pay the amount due to the IRS." *Brounstein*, 979 F.2d at 954; *see also United States v. Schroeder*, 900 F.2d 1144 (7th Cir.1990); *Psaty v. United States*, 442 F.2d 1154 (3d Cir. 1971).

We agree with the *Branson* court's decision which specifically rejected the *Griffith* decision and reasoned that:

> The language of section 13½ of the [ROTA] would be senseless without construing it to mean that the Department's determination was prima facie proof of all elements of the penalty. The Department can assess no penalty without

> finding wilfulness. Thus, in the absence of wilfulness on the part of the responsible individual, the correct amount of any penalty is $0. Accordingly, we hold that the Department's determination of a penalty due against a responsible individual establishes a prima facie case regarding all the statutory elements required for imposition of such a penalty.

Branson, 206 Ill.Dec. at 144, 644 N.E.2d at 1197.

Finally, we are persuaded by the *Branson* court's opinion that it is reasonable to shift the burden to the taxpayer in tax cases. As *Branson* noted, a taxpayer has better access to his or her records and witnesses to rebut the Department's claim of wilfulness.

Accordingly, we find that the Department's determination of a penalty due against a responsible individual establishes a prima facie case regarding all the statutory elements required for imposition of such a penalty.

The Bankruptcy Court's ruling requires this court to remand the action so that the Bankruptcy Court may properly determine whether the Debtor wilfully failed to pay the taxes as assessed against Chandler. The NPL shall be considered prima facie proof of the Debtor's wilfulness which the Trustee will have the burden to rebut. The Bankruptcy Court may wish to re-open the proof so that both parties can introduce evidence in the light of this Supplemental Opinion. After hearing all the evidence offered by the parties, the Bankruptcy Court should determine whether the Trustee successfully proved that the Debtor's inaction was not wilful.

The Trustee also moves this court for certification for interlocutory appeal pursuant to 28 U.S.C. § 1292(b). The Trustee argues that certification is warranted because this court's August 30, 1994 Memorandum, Opinion and Order as well as this Supplemental Memorandum, Opinion and Order involve controlling questions of law as to which there is substantial ground for difference of opinion.

As a general proposition, "permission to take an interlocutory appeal should be granted sparingly and with discrimination." *In re Brand Name Prescription Drugs Antitrust Litigation*, 1995 WL 9216, No. 94 C 897 (N.D.Ill. Jan. 9, 1995) (*quoting In re Folding Carton Antitrust Litigation*, 75 F.R.D. 727, 738 (N.D.Ill.1977)). When deciding a motion for certification, the district court must consider the following factors: (1) whether the motion to be appealed involves a controlling question of law; (2) whether there is a substantial ground for difference of opinion on that question of law; and (3) whether an immediate appeal from the order may materially advance the ultimate termination of the litigation. 28 U.S.C. § 1292(b); *Segni v. Commercial Office Spain*, 650 F.Supp. 1045, 1046 (N.D.Ill.1987). Although the two issues on appeal in this court involve controlling questions of law on which opinions reasonably differ, we find that an appeal at this time will not materially advance the ultimate termination of this litigation. The ultimate termination of this litigation will be best advanced if the Bankruptcy Court re-decides the issues in the light of this court's Opinions. The parties then can contemplate an appeal. This court will expeditiously decide any appeal made to it so that the parties may swiftly move on to the

Circuit Court of Appeals if either one of them wishes to submit these thorny issues to it.

CONCLUSION

We, therefore, reverse the Bankruptcy Court's decision to disallow the claim on the merits and remand this action to the Bankruptcy Court to determine whether the Debtor was a responsible officer who "wilfully" failed to pay the assessed tax. If the Bankruptcy Court allows the claim, then it must determine whether the claim should be equitably subordinated in accordance with this court's August 30, 1994 Memorandum, Opinion and Order. After these decisions are made, the matter will be ripe for appeal. Accordingly, we deny the motion of the Trustee to certify for interlocutory appeal pursuant to 28 U.S.C. § 1292(b).

It is so ordered.

APPENDIX E

In re William J. STOECKER, Debtor.
Bankruptcy No. 89 B 02873.

United States Bankruptcy Court,
N.D. Illinois, E.D.
Nov. 25, 1992.
Opinion Denying Reconsideration
Feb. 23, 1993.

James D. Newbold, Asst. Atty. Gen., Illinois Dept. of Revenue, Chicago, IL, for Illinois Dept. of Revenue.

Thomas Raleigh, Raleigh & Helms, Chicago, IL, Trustee.

Robert Radasevich, Neal, Gerber & Eisenberg, Chicago, IL, for the trustee.

M. Scott Michel, Chicago, IL, U.S. Trustee.

MEMORANDUM OPINION ON RECONSIDERATION

JOHN H. SQUIRES, Bankruptcy Judge.

This matter comes before the Court on the objection of Thomas E. Raleigh, Chapter 7 trustee (the "Trustee") for the estate of William J. Stoecker (the "Debtor"), to a proof of claim, as subsequently amended, filed by the Illinois Department of Revenue (the "Department"). For the reasons set forth herein, the Court having considered all the pleadings and evidence adduced at trial by way of testimony and exhibits, sustains the objection and disallows the subject proof of claim.

I. *JURISDICTION AND PROCEDURE*

The Court has jurisdiction to entertain this objection to claim pursuant to 28 U.S.C. § 1334 and General Rule 2.33(A) of the United States District Court for the Northern District of Illinois. This matter constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(B).

II. *FACTS AND BACKGROUND*

On February 21, 1989, an involuntary petition under Chapter 11 was filed against the Debtor. Thereafter, on March 20, 1989, the Trustee was appointed Chapter 11 trustee of the estate for cause. On February 26, 1990, the case was converted to Chapter 7. The Trustee remained as the Chapter 7 trustee. Many more of the facts, background and history of this case are contained in earlier Opinions. *See In re Stoecker*, 118 B.R. 596, 598-599 (Bankr.N.D.Ill.1990); *In re Stoecker*, 114 B.R. 965, 967-968 (Bankr.N.D.Ill.1990); *In re Stoecker*, 103 B.R. 182, 184-185 (Bankr.N.D.Ill.1989). Additional background information concerning the related corporate cases is contained in other Opinions of the Court. *See In re Grabill Corp.*, 110 B.R. 356, 358 (Bankr.N.D.Ill.1990); *In re Grabill Corp.*, 103 B.R. 996, 997-998 (Bankr.N.D.Ill.1989).

Upon conversion of the case from Chapter 11 to Chapter 7, the Court by Order dated March 5, 1990, set the 11 U.S.C. § 341 meeting of creditors for March 28, 1990, as required by Federal Rule of Bankruptcy Procedure 2003(a). That Order provided that all proofs of claim were to be filed within ninety days after the section 341 meeting of creditors, on or before June 26, 1990, pursuant to Bankruptcy Rule 3002(c). On November 28,

1990, pursuant to an agreed order, the Debtor's discharge was denied under 11 U.S.C. § 727 in settlement of various filed objections to discharge.

Prior to conversion, the Department filed three proofs of claim on July 25, 1989, when the case was still in its Chapter 11 phase. The first two claims are for withholding tax and Retailers' Occupation/Use Tax (Ill.Rev.Stat. ch. 120, para. 440 *et seq.* and para. 439.1 *et seq.*) owed by the Debtor as responsible officer of The Cook's Cupboard. The amounts of these claims are $12,667.00 and $1,330.21. (Department Exhibit No. 16). The third claim for $222.03 is asserted against the Debtor as responsible officer of Eagle Line, Inc. for Retailers' Occupation/Use Tax. (Department Exhibit No. 16). Thereafter, on November 17, 1989, the Department filed an amended proof of claim, asserting additional taxes owed by the Debtor as responsible officer for The Cook's Cupboard in the amount of $14,630.00. (Answer of Department to Objection to Claim, Exhibit D). The amount of the Department's timely filed proofs of claim totals $14,852.03. No other objections thereto have been filed, thus those claims were deemed allowed under 11 U.S.C. § 502(a) and Bankruptcy Rule 3001(f), although the claims for $1,330.21 and $14,630.00 have been withdrawn by the Department. (Department Exhibit No. 18).

On January 21, 1992, approximately a year and a half after the claims bar date, the Department filed the subject contested proof of claim (Trustee's Objection to Proof of Claim, Exhibit B) which represents Retailers' Occupation/Use Tax allegedly owed by the Debtor as responsible officer for Chandler Enterprises, Inc. ("Chandler"). *See* Ill.Rev.Stat. ch. 120, para. 452 1/2 (1991). The basis of

the claim (subsequently amended to reflect a reduction per an amended claim dated September 3, 1992) arises from Chandler's purchase of an aircraft in 1988. Chandler was an Illinois Corporation, incorporated on January 24, 1985. (Department Exhibit Nos. 19 and 20). The Debtor was president and sole director, but not the sole officer, of Chandler from 1985 to 1990. *Id.* Chandler was involuntarily dissolved by the Illinois Secretary of State on June 1, 1990. (Department Exhibit No. 20, p. 5).

According to the records of the Federal Aviation Administration, Chandler purchased a Dassault Falcon 50 aircraft from Prewitt Leasing, Inc. on September 30, 1988. (Department Exhibit No. 7). The preceding link in the chain of title also showed on that same date, Jack Prewitt & Associates, Inc. sold the aircraft to Prewitt Leasing, Inc., prior to Prewitt Leasing, Inc.'s sale of the aircraft to Chandler. (Department Exhibit No. 6). The aircraft was previously sold to Jack Prewitt & Associates, Inc. on June 1, 1988, by Opex Aviation, Inc. (Department Exhibit Nos. 5 and 5A). The aircraft was subsequently leased by Chandler to Grabill Corporation for the period of September 30, 1988 through December 30, 1988, at a basic monthly rental of $172,752.25. (Department Exhibit No. 8, p. 00000002332).

Neither Chandler nor Prewitt Leasing, Inc. paid any sales/use tax, withholding tax or income tax on Chandler's purchase of the aircraft. John Anderson, counsel for Chandler and Grabill, issued an opinion concluding that under Illinois law, there was no sale or use tax properly assessable or payable as a result of the purchase of the aircraft by Chandler or the lease of the aircraft by Chandler to Grabill. (Trustee Exhibit No. 3). Such legal

opinion was supported by the vice-president of Prewitt Leasing, Inc. who signed a "Certificate Re Occasional Seller Exemption from Illinois Sales and Use Tax" on September 30, 1988. (Trustee Exhibit No. 4).

On March 7, 1990 and June 7, 1990, weeks before the claims bar date, the Department sent Chandler two letters demanding payment of the claimed tax due. (Trustee Exhibit Nos. 3 and 4). Subsequently, on September 7, 1990, a Notice of Penalty Liability was issued against Chandler. (Department Exhibit No. 10). Almost one year later, on August 15, 1991, a Notice of Penalty Liability was issued against the Debtor. (Department Exhibit No. 1). On September 25, 1991, the Department sent the Debtor a demand for full payment of the tax liability claimed. (Department Exhibit No. 13). The Trustee subsequently objected to allowance of this late filed claim pursuant to Bankruptcy Rule 3007. On July 30, 1992 and August 27, 1992, the Court held the trial on this matter. Thereafter, the matter was taken under advisement after submission of post-trial briefs.

III. *ARGUMENTS OF THE PARTIES*

The Trustee has objected to the late filed claim of the Department on two grounds: (1) the claim was filed after the bar date fixed by Bankruptcy Rule 3002(c), and hence is untimely; and (2) the claim against the Debtor as responsible officer of Chandler is invalid as the underlying purchase of the aircraft by Chandler was an "occasional sale" exempt from sales/use tax.

The Department does not deny that its claim filed on January 21, 1992 is untimely. Instead, the Department

contends that the claim should be treated as an amendment to the earlier filed proofs of claim pursuant to Federal Rule of Civil Procedure 15. In the alternative, the Department requests the Court utilize its equitable powers to allow the claim though late filed. The Department explains that it failed to file a timely claim against the Debtor as responsible officer of Chandler because Chandler never registered with the Department for any type of tax, and never filed a tax return with the Department during its corporate existence. By the time the Department discovered that Chandler was engaged in taxable activities and that the Debtor was a responsible officer of Chandler, the claims bar date had passed. The Department maintains, however, that by previously filing responsible officer tax claims, it has clearly evidenced its intention of claiming any and all responsible officer liability against the Debtor and his bankruptcy estate.

The Department contends its efforts to file a timely claim were impeded as a result of Chandler's conduct and omissions. It alleges that Chandler acted improperly in failing to register with the Department or file tax returns regarding its purchase and lease of the aircraft. Moreover, the Department contends that Chandler attempted to conceal the taxability of the transaction by having title to the aircraft transferred from Jack Prewitt & Associates, Inc., a retail seller of aircraft, to Prewitt Leasing, Inc., a purported lessor of aircraft, so that it could claim the "occasional sale" exemption.

The Trustee contends that the sale of the aircraft to Chandler was an "occasional sale" of property at retail, exempt from sales/use tax. The Trustee argues that Anderson's opinion letter properly concluded that the

transaction was exempt from taxes. The Department disagrees with this contention and claims that in order to create a sale that was ostensibly exempt from tax, Jack Prewitt & Associates, Inc. sold the aircraft to Prewitt Leasing, Inc. who in turn acted as a nominal "straw man" and immediately thereafter sold it to Chandler. The Department contends the true seller was Jack Prewitt & Associates, Inc., and that the sale was not an "occasional sale" exempt from tax.

IV. *APPLICABLE STANDARDS*

Pursuant to Federal Rule of Bankruptcy Procedure 3002(c), a creditor in a Chapter 7 case is required to file a proof of claim within ninety days after the date first set for the meeting of creditors called under 11 U.S.C. § 341. There are several specific instances where the time for filing proofs of claim may be extended in a Chapter 7 case, none of which are applicable here. *See* Fed.R.Bankr.P. 3002(c). Thus, Bankruptcy Rule 3002(c)(1) requires that a claimant, like the Department, must first move for an extension within the permitted ninety days, which it did not do. The Court's authority to extend the time for filing proofs of claim is also severely limited by Bankruptcy Rule 9006. Pursuant to Bankruptcy Rule 9006(b)(3), the Court is allowed to extend the time for creditor/claimants taking action under Bankruptcy Rule 3002 only "to the extent and under the conditions stated in [the rule]." Fed.R.Bankr.P. 9006(b)(3). Thus, "Bankr.R. 3002(c) is strictly construed as a statute of limitations since the purpose of such a claims bar date is 'to provide the debtor and its creditors with finality' and to 'insure the swift distribution of the bankruptcy estate.' " *In re*

Robert Stone Cut Off Equipment, Inc., 98 B.R. 158, 160 (Bankr.N.D.N.Y.1989) (quoting *In re Johnson*, 84 B.R. 492, 494 (Bankr.N.D.Ohio 1988) and *In re Good News Publishers, Inc.*, 33 B.R. 125, 126 (M.D.Tenn.1983)). *See also In re Chirillo*, 84 B.R. 120, 121-122 nn. 2-3 (Bankr.N.D.Ill.1988) (collecting cases).

Bankruptcy Rule 3002(c) can operate in conjunction with Federal Rule of Bankruptcy Procedure 7015 which incorporates by reference Federal Rule of Civil Procedure 15. Rule 15(c) provides in pertinent part:

> An amendment of a pleading relates back to the date of the original pleading when
>
> . . .
>
> (2) the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading. . . .

Fed.R.Civ.P. 15(c). Bankruptcy Rule 7015 provides that "Rule 15 FR Civ P applies in adversary proceedings." Fed.R.Bank.P. 7015. While normally an objection to a claim is not a formal adversary proceeding, Bankruptcy Rule 9014 allows courts at any stage of a contested motion or other matter, to extend Bankruptcy Rule 7015, among other rules, to contested matters which includes the Trustee's objection to the Department's claim. *See In re Unroe*, 937 F.2d 346, 349 (7th Cir.1991). No such order or direction was made in this matter pursuant to Bankruptcy Rule 9014.

The decision to allow an amendment to a proof of claim is within the sound discretion of the Court. *In re Stavriotis*, 977 F.2d 1202, 1204 (7th Cir.1992); *Unroe*, 937

F.2d at 350; *In re Candy Braz, Inc.*, 98 B.R. 375, 380 (Bankr.N.D.Ill.1988). Amendments to timely filed claims are liberally allowed to modify information or correct omissions in the original claim. *In re Calisoff*, 94 B.R. 1002, 1003 (Bankr.N.D.Ill.1988). Amendments to proofs of claim are also permitted if "the original claim provided notice to the court of the existence, nature and amount of the claim and that it was the creditors' intent to hold the estate liable." *In re International Horizons, Inc.*, 751 F.2d 1213, 1217 (11th Cir.1985). Amendments to claims are closely scrutinized to ensure that the amendment is genuine rather than an assertion of an entirely new claim. *Candy Braz*, 98 B.R. at 380; *In re AM International, Inc.*, 67 B.R. 79, 81 (N.D.Ill.1986). "[T]o be within the scope of a permissible amendment, the second claim should not only be of the same nature as the first but also reasonably within the amount to which the first claim provided notice." *Id.* at 82.

"[B]ankruptcy courts are not required to permit late amendments which are primarily used as a back-door route to secure bar-date extensions. Were the rule otherwise, a party could effectively help itself to automatic extensions of the bar date without seeking leave of the court." *Stavriotis*, 977 F.2d at 1206. While leave to amend should generally be granted, courts have found it inappropriate in some circumstances. *See Amendola v. Bayer*, 907 F.2d 760, 764 (7th Cir.1990) (denial of leave to file amended claim affirmed where party was aware of the facts underlying the claim prior to the filing deadline and presented no excuse for failing to raise the claim earlier; opposing party would be unduly prejudiced; and delay would impair the public interest in prompt resolution of

disputes). "[U]nlike a chapter 11 proceeding, the court reviewing a chapter 7 or chapter 13 proof of claim has no discretion to allow an untimely filed claim on the grounds of excusable neglect." *In re Couzens Warehouse & Distributors, Inc.*, 1991 WL 233314 at *1, 1991 Bankr. LEXIS 1591 at *2 (Bankr.N.D.Ill. Oct. 17, 1991); *In re Smartt Constr. Co.*, 138 B.R. 269, 271 (D.Colo.1992) ("A majority of courts agree that the bar date for Chapter 7 and Chapter 13 proofs of claim cannot be extended for excusable neglect.").

The Court's authority to allow the late filed claim of the Department is not absolutely limited by statute or rule. Another potential basis for allowing the claim is the Court's equitable powers. This authority was recently discussed by the Seventh Circuit Court of Appeals in *Unroe*, 937 F.2d 346, which noted, "[e]quitable jurisdiction to permit amendments out-of-time does not conflict with, but rather fulfills, the statutory backdrop for bankruptcy proceedings. The bankruptcy court below therefore properly considered equitable matters outside the scope of the test of Fed.R.Civ.P. 15(c) in deciding to permit the late-filed claim as an 'amendment.' " *Id.* at 349-350. The *Unroe* court expressly stated, however, that late filed claims disrupt orderly discharge and should generally be barred. *Id.* at 351.

In *Unroe*, the court permitted the late filing of a claim for income taxes which had been scheduled at a higher amount in the debtor's Chapter 13 plan. The debtor included in her plan of confirmation $15,000.00 for taxes owed for the years 1982 and 1983. The IRS filed a timely proof of claim for 1982 taxes, but failed to file a claim for 1983 taxes until after the claims bar date. The sum total

for both 1982 and 1983 taxes sought by the IRS in its untimely amendment, however, was $10,914.21, approximately $4,000.00 less that the $15,000.00 the debtor listed as tax liabilities. The court found that neither the debtor nor the creditors were prejudiced by the allowance of the late filed claim for the 1983 taxes. The court stated, however, that "[t]he result may have been different had the late claim been unscheduled or exceeded the amount in the plan, in which cases the prejudice to the debtor and other creditors would have been more severe." 937 F.2d at 351.

In holding that the bankruptcy courts' equitable powers included the authorization of late filed claims, *Unroe* noted that such an exercise of equity must include identification of factors related to the debtor's notice of a pending claim or excusable neglect by the creditor. *Id.* at 350 n. 5. The holding in *Unroe*, however, did not extend to an entirely new claim filed after the bar date. Specifically, the court noted, "[w]e leave for another case the question whether a judge in equity could permit an entirely new claim filed out of time." *Id.* at 350.

Another contrary approach has been taken by the United States Bankruptcy Court for the District of Minnesota, sitting *en banc* in *In re Hausladen*, 146 B.R. 557 (Bankr.D.Minn.1992). There the court principally focused on the absence of an exception under section 502 for late claims as a basis for disallowance. *Hausladen* involved late filed Chapter 13 claims subject to the same bar date period prescribed by Bankruptcy Rule 3002(c). There, the court noted that Rule 3002 does not explicitly state that timely filing is a prerequisite to allowance and that section 502(b) does not specify tardiness in filing as one of

the eight statutorily enumerated grounds for disallowing claim. In discussing various ways a tardily-filed claim may be treated under a Chapter 13 plan, the court aptly noted that treatment or classification of claims is different from their allowance. 11 U.S.C. § 726, however, provides for distribution of property of the estate and that timely filed claims enjoy priority in distribution over tardily-filed claims. *Compare* 11 U.S.C. § 726(a)(2) with (a)(3). In most Chapter 7 cases, like this one, a claim holder's "rung" on the priority "ladder" created under section 726 is crucial because the estate assets are limited. There are usually insufficient assets to pay all claimants in full, and section 726(b) mandates pro rata distribution among all claimants at each level, or rung of the priority ladder, with an absolute priority cutoff. All allowed claimants at a particular level or rung of the ladder must be paid in full before any estate funds can be distributed to holders of claims at the next lower rung. Thus, the race among claimants is to reach the highest rung on the claims ladder.

Hausladen is premised upon the proposition that the time limits of Rule 3002(c) cannot be imposed on the exceptions to allowance provided in the statutory language of section 502(b). The rule, however, setting a limitations period does not necessarily conflict with the statute because the latter is silent on tardily-filed claims. Section 502(b)(1) does state an exception of claims unenforceable "against the debtor . . . under any . . . applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C. § 502(b)(1). Such exception logically includes the applicable law of the claims bar

date established by Bankruptcy Rule 3002(c), promulgated by the Supreme Court of the United States pursuant to the congressional authority granted it by the Rules Enabling Act. *See* 28 U.S.C. § 2075. Thereby, Congress has at least tacitly allowed the Supreme Court to prescribe the applicable statute of limitations contained in Bankruptcy Rule 3002. As a general proposition, statutes of limitation are to be strictly construed. *See In re Friedman*, 15 B.R. 493, 494 (Bankr.N.D.Ill.1981). This principle is appropriately applied in light of the text of Bankruptcy Rule 9006(b). Accordingly, the Court will follow the rationale behind *Chirillo*, as tempered by *Unroe* and *Stavriotis* which are binding precedents in this circuit, while *Hausladen* is not. Thus, the Court declines to follow *Hausladen*.

The Department alternatively relies on the equitable factors enumerated in *In re Miss Glamour Coat Co.*, 80-2 U.S.T.C. ¶ 9737 (S.D.N.Y.1980). *Unroe* recognized the applicability of these factors. 937 F.2d at 350-351. Pursuant to *Miss Glamour Coat*, a court may, in its discretion, allow a late filed proof of claim. The factors that must be considered include the following:

> (1) whether the parties or creditors relied on the Department's initial claim, or whether they had reason to know subsequent proof of claim would follow pending the completion of the audit;
>
> (2) whether other creditors would receive a windfall to which they are not entitled on the merits by the court not allowing this amendment to the Department's proof of claim;

(3) whether the Department intentionally or negligently delayed in filing its amended claim;

(4) the justification, if any, for the failure to request a timely extension of the bar date; and

(5) any other general equitable considerations.

Id. at 85, 434-435.

V. *DISCUSSION*

A. Whether the Department's Claim Should be Deemed or Allowed as Timely Filed

The Trustee alleges that because the Department's proof of claim was filed after the bar date, and because the Department never asked for an extension of time to file its proof of claim before the expiration of the bar date as required by Bankruptcy Rules 3002(c)(1) and 9006(b)(3), the claim must be disallowed as untimely. The Court agrees and hereby finds that the Department's claim was admittedly tardily-filed. The Department could have timely moved for an extension of time within the ninety day period as contemplated by Bankruptcy Rule 3002(c)(1). It failed to so move, and hence pursuant to Bankruptcy Rules 3002(c) and 9006(b)(3) the Court will not allow the claim as timely filed.

Moreover, viewed under Rule 15(c), the Court finds that the late filed claim did not arise out of any of the same transactions or occurrences set forth in the four timely claims filed by the Department before the bar date. None of those claims concerned taxes owed by Chandler or the Debtor as a responsible officer of that entity. The Department's purported amendment arises out of a tax

imposed against an entirely different entity than any referenced in its timely filed claims. Additionally, the Court finds that the instant late filed claim is for an amount greatly exceeding the aggregate of all its timely filed claims. Thus, the Court concludes that the subject proof of claim is not a proper amendment to any of the earlier filed proofs of claim, but rather an entirely new claim. *See e.g., Am International*, 67 B.R. at 82 (a claim for approximately $11,000.00 does not give parties notice of a claim of over $2,000,000.00, even though the creditors had notice that the amount of taxes had not yet been determined).

Furthermore, the Department contends that by timely filing claims against the Debtor as a responsible officer of The Cook's Cupboard and Eagle Line, Inc., it demonstrated an intent to assert claims against the Debtor and the estate for any liability the Debtor has as a responsible officer for any type of trust fund tax for which it could make a personal claim against him. The Court finds this argument unpersuasive. Taken to its logical conclusion, this argument purports to put the estate, and all its other creditors, on sufficient notice of any and all taxes due and owing by the Debtor from any corporation of which the Debtor was a responsible officer. While the filing of the previous claims against the Debtor as responsible officer of those other corporations may be a clear indication of the Department's intent to hold the Debtor responsible for taxes in those corporations, the Court is not willing to extend this argument as effective notice to all other parties in interest concerning any and all other corporations of which the Debtor may potentially be held to be a responsible officer for sales or use taxes in unspecified

amounts. Accordingly, the Court hereby declines to allow the Department to amend its earlier proofs of claim pursuant to Bankruptcy Rule 7015.

In addition, the Court declines to allow the late filed claim under its equitable power and exercise of discretion as set forth in *Unroe* and *Stavriotis*. The Court respectfully distinguishes the result reached here with that in the *Unroe* and *Stavriotis* decisions. First, neither *Unroe* nor *Stavriotis* made reference to Bankruptcy Rule 9006(b)(3), which allows extensions of time only and to the extent provided in Bankruptcy Rule 3002(c). The Court views such omission to reference the mandatory limits of Rule 9006(b)(3) as a major limitation in the appropriate application of those decisions. Moreover, in *Unroe* the debtor scheduled the IRS for a larger amount than the actual amount finally claimed, in contrast to the facts of this matter where the Debtor, at all times, asserted his Fifth Amendment privilege against self-incrimination, and never filed schedules of assets or liabilities. Thus, the Trustee and the interested creditors were left to their own resources to ferret out the Debtor's liabilities, including the instant contested claim which only surfaced of record over a year after the claims bar date had run.

Next, in applying the *Glamour Coat* balancing test, which *Unroe* adopted, the Court concludes that the equities weigh in favor of disallowance of the subject claim. No evidence in the record offers any compelling explanation for the Department's failure to request an extension of the bar date. The Department was a scheduled creditor, received notice of the claims bar date, and timely filed four proofs of claim. The Department filed the late claim one and a half years after the bar date. Moreover, the

Court finds that the Department did not exercise due diligence in filing its claim. Pursuant to the testimony of Mark Russell, a revenue auditor for the Department, the investigation of the September 1988 aircraft transfer did not begin until February or March 1990, months prior to the claims bar date. The evidence adduced at trial indicated that the Department was well aware of the pendency of this case. Russell further testified that he was aware in July 1990 that the Debtor was the president of Chandler. The Department, however, did not send out a Notice of Penalty Liability to the Debtor until August 15, 1991. It subsequently waited until January 21, 1992 to file the subject proof of claim. The Court concludes that these belated actions do not constitute due diligence.

Although the Department's actions for purposes of assessment under the Retailers' Occupation/Use Tax Acts may be timely and within the applicable statute of limitations, that is insufficient on these facts to establish the requisite diligence for timely filed bankruptcy proofs of claim as required under Bankruptcy Rules 3002(c) and 9006(b)(3). The Court similarly rejects the Department's arguments that employees of one of its units were unaware of what other employees in its other units were doing. This is a classic bureaucratic excuse that the right hand was unaware of what the left hand was doing or had done. The applicable Bankruptcy Rules do not provide for such an exception. Bankruptcy Rule 3002(c)(1) merely contemplates a timely motion for an extension of time which could have been requested, but was not sought. The Department is the claimant, however, not its various units or employees, and as an entity and claimant is held to the requirements of the Bankruptcy Rules.

In addition, nothing in the record indicates that the Trustee or other interested parties were on notice that there would be any additional claims for taxes due and owing by Chandler, a corporation which was not mentioned in any of the Department's timely filed proofs of claim. Furthermore, no creditor will receive a windfall if the subject contested claim is disallowed. The Trustee has estimated that the unsecured creditors in the estate will receive approximately a twenty percent dividend distribution.

The Department claims the timely filed proofs of claim covered the taxable period of July, 1986 through July, 1989, and the amended claim at issue is for the period of September, 1988. The Department further argues that its efforts to timely file a claim were impeded because Chandler attempted to conceal the taxability of the transaction by having title to the airplane transferred from the retailer, Jack Prewitt & Associates, Inc. to Prewitt Leasing, Inc. so that it could claim the "occasional sale" exemption. The Department claims that it did not file a timely claim with regard to the aircraft purchase because Chandler never registered with the Department for any type of tax and never filed a tax return with the Department during its corporate existence. Russell, however, admitted that a corporation is not required to register or to file a tax return if it has no income and has not engaged in a taxable transaction. The Department counters that Chandler was seeking to evade payment of the tax. The Court finds this argument misplaced. The Department cannot assert Chandler's acts or omissions as a compelling defense for its own inaction under the facts of this matter in light of the history of the Department's

timely prior actions in connection with its other claims in this case. In the pleadings, the Department sets forth the proposition and cites supporting cases that concealment of a cause of action suspends the running of applicable statutes of limitations. Although the Department is contending that the Debtor and Chandler fraudulently concealed the taxability of the subject transaction, no evidence of fraud or conspiracy was presented supporting this conclusion. Therefore, the Court will not further address this argument and rejects same.

Upon balancing the equities, the Court finds that the equities really favor the other unsecured creditors whose allowed claims were timely filed and whose dividends should not be diluted through allowance of the subject contested claim. After all, the Department has other potential sources of recovery for its assessed unpaid taxes, namely Chandler and its assets, if any, other potentially responsible officers of Chandler and their assets, and the Debtor and his assets as a result of the denial of his discharge.

B. *The Underlying Claim Against the Debtor as Responsible Officer of Chandler*

Concerning the Trustee's second defense attacking the merits of the Debtor's liability for the Department's claim, the Court must first address the Department's contention that this Court lacks jurisdiction to determine the tax liability of a non-debtor entity such as Chandler. For this proposition, the Department cites several cases. *See In re Brandt-Airflex Corp.*, 843 F.2d 90 (2d Cir.1988); *United States v. Huckabee Auto Co.*, 783 F.2d 1546 (11th

Cir.1986); *In re Success Tool & Mfg. Co.*, 62 B.R. 221 (N.D.Ill.1986). These cases are distinguishable from the case at bar. In the cited cases, the debtors sought to have the court shift a tax liability to a non-debtor. That is not the situation in this matter. Thus, the Court declines to follow this inapposite line of authority.

Pursuant to 11 U.S.C. § 505(a)(1), the Court is authorized to "determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction." Several courts have held that the bankruptcy court may apply section 505(a) to determine the tax liability of parties other than the debtor. *See In re Wolverine Radio Co.*, 930 F.2d 1132 (6th Cir.1991), *cert. denied*, ___ U.S. ___, 112 S.Ct. 1605, 118 L.Ed.2d 317 (1992) (bankruptcy courts have jurisdiction over disputes involving unemployment compensation tax liability incurred by debtors, but same may include tax disputes concerning non-debtors when that dispute affects the debtors and when exercise of that jurisdiction is necessary to rehabilitate the debtor or to administer its estate effectively); *In re Goldblatt Bros., Inc.*, 106 B.R. 522 (Bankr.N.D.Ill.1989) (court held that determination of whether creditors' committee was responsible for paying taxes on interest earned on money held in an account established pursuant to the Chapter 11 plan was a core proceeding); *In re John Renton Young, Ltd.*, 87 B.R. 635 (Bankr.D.Nev.1988) (court had jurisdiction to determine debtor's motion for injunctive relief from a one-hundred percent penalty tax assessment against the non-debtor obligor based on his relationship with the

debtor as its president and only shareholder); *In re Jon Co.*, 30 B.R. 831 (D.Colo.1983) (court determined the 26 U.S.C. § 6672 tax liability of the debtor's employees); *In re H & R Ice Co.*, 24 B.R. 28 (Bankr.W.D.Mo.1982) (same); *In re Major Dynamics, Inc.*, 14 B.R. 969 (Bankr.S.D.Cal.1981) (court stayed IRS audits, assessments and collections directed at the creditors of the estate). In *Major Dynamics*, the court acknowledged that the legislative history of section 505 focuses on tax obligations of the debtor or the debtor's estate. It held, however, that the "any tax" language used in section 505(a)(1) must control and "that the Bankruptcy Court has jurisdiction to determine disputes between third party creditors and the IRS in an appropriate case." 14 B.R. at 972. The court opined that an "appropriate case" included "tax disputes of third parties other than the debtor *provided, however*, that the IRS activity to be enjoined directly affected the debtor or the estate, and that the exercise of such jurisdiction was necessary to the rehabilitation of the debtor or the orderly and efficient administration of the debtor's case." *Id.* (emphasis in original).

In the instant matter, the parties ask the Court to determine the Debtor's liability as responsible officer of a non-debtor corporation. The Debtor's liability, in part, depends on whether Chandler actually owes the tax. The determination of the tax assessed against Chandler directly affects the Debtor, who was denied a discharge, and the potential dividend distribution from the estate. Moreover, the determination of this issue is necessary for the orderly and efficient administration of the estate. *See Major Dynamics*, 14 B.R. at 972. Having been denied a discharge, the Debtor has a personal stake in the outcome

of Chandler's (and his) tax liability. *See Jon Co.*, 30 B.R. at 833-834. Thus, under the plain language used in section 505(a)(1), the Court can examine the asserted tax liability of Chandler. *See e.g., Wolverine Radio*, 930 F.2d at 1140-1143. Moreover, under 11 U.S.C. § 558, the Trustee may assert any defense available to the Debtor for the benefit of the estate including defenses personal to the Debtor. Thus, even though the Debtor may not have protested the notice of assessment sent by the Department to him, the Trustee may still assert substantive defenses to the claim as argued here. *See* 11 U.S.C. § 558.

The Department asserts and has assessed personal liability on the Debtor as a corporate officer of Chandler pursuant to Section 13½ of the Retailers' Occupation Tax Act, which provides in pertinent part:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed . . . and who willfully fails to file such return or to make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon. . . .

Ill.Rev.Stat. ch. 120, para. 452½ (1991).

The Illinois Supreme Court has held that the willful failure to pay requirement is satisfied with a showing of "voluntary, conscious and intentional failure" to make the tax payments. *Department of Revenue v. Heartland Invest., Inc.*, 106 Ill.2d 19, 30, 86 Ill.Dec. 912, 476 N.E.2d 413 (1985)

(quoting *Department of Revenue v. Joseph Bublick & Sons, Inc.*, 68 Ill.2d 568, 577, 12 Ill.Dec. 265, 369 N.E.2d 1279 (1977)); *Department of Revenue v. Corrosion Systems, Inc.*, 185 Ill.App.3d 580, 583-584, 133 Ill.Dec. 647, 649, 650, 541 N.E.2d 858, 860, 861 (4th Dist.1989). Moreover, "in a civil action, wilful conduct does not require bad purpose or intent to defraud the government." *Heartland Invest.*, 106 Ill.2d at 30, 86 Ill.Dec. 912, 476 N.E.2d 413. The *Bublick* court further found that the determination of willful failure "is an issue of fact to be determined by the trier of the fact on the basis of the circumstances and evidence adduced in the particular case." *Bublick*, 68 Ill.2d at 577, 12 Ill.Dec. 265, 369 N.E.2d 1279.

The Retailers' Occupation Tax Act further establishes the procedure for creating and assessing the liability against a corporate officer:

> The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section. Proof of such determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. Such reproduced copy shall, without further proof, be admitted into evidence before the Department or any legal proceeding and shall be prima facie proof of the correctness of the penalty due, as shown thereon.

Ill.Rev.Stat. ch. 120, para. 452½.

The Department established prima facie proof of the correctness of the penalty by introducing a copy of the Notice of Penalty Liability issued against the Debtor. (Department Exhibit No. 1). At trial, the Trustee presented evidence to the contrary, namely the opinion testimony of John Anderson which concluded the sale was not taxable, as well as the supporting certificate of occasional seller exemption executed on behalf of Prewitt Leasing, Inc. As a result of this evidence, the ultimate burden of proof and persuasion shifted back to the Department. *See generally, People ex rel. Dept. of Revenue v. National Liquors Empire, Inc.*, 157 Ill.App.3d 434, 439, 109 Ill.Dec. 627, 630-631, 510 N.E.2d 495, 498-499 (4th Dist.1987). The Department's assessment notice to the Debtor and the prima facie effect of para. 452½ without more evidence are insufficient. Even proof that Chandler may be liable for the tax is not ipso facto sufficient to show the Debtor liable as a responsible officer.

The Court finds that the Department has failed to meet its burden and establish that the Debtor willfully failed to pay the tax assessed against Chandler for the sale of the aircraft. On the required element of corporate control, it is uncontested that the Debtor was president and sole director of Chandler. Although by no means certain, the Court can reasonably infer that the Debtor, as such officer and director, was in control of Chandler. No compelling evidence, however, was presented on the issue of whether the Debtor's failure to pay the claimed tax was voluntary, conscious and intentional. John Anderson testified that Lawrence Pluhar acted as the Debtor's chief financial officer, and thus is putatively another potential responsible Chandler officer against whom the

Department could proceed. Chandler's annual corporate report for 1988 showed two other officers who may be additional potentially responsible officers. (Department Exhibit No. 19, p. 3). There was no evidence presented of the Debtor's voluntary, conscious and intentional failure to pay the tax. Evidence that the Department sent the notice of assessment to the Debtor, and he has not paid same or responded to the Department's demands, is not the equivalent of a conscious or intentional failure on his part.

As a matter of law, the automatic stay under 11 U.S.C. § 362(a) was effective from the time the petition was filed in February, 1989, over two years prior to the Department's August 15, 1991 issuance of its Notice of Penalty Liability to the Debtor. That his pre-petition property which passed to the Trustee as property of the bankruptcy estate under 11 U.S.C. § 541 was not available to satisfy this contested claim, does not serve as the equivalent of adequate proof of the Debtor's voluntary, conscious and intentional failure to pay.

In addition, in *Corrosion Systems*, the corporate officer against whom the Department sought to impose responsible party liability, signed the corporation's tax reports and checks accompanying same. 185 Ill.App.3d at 5[illegible]3-584, 133 Ill.Dec. at 650, 541 N.E.2d at 861. The court there concluded, however, that "the officer had relied on his accountant, and there was no evidence 'that the defendant consciously, voluntarily, intentionally, knowingly or recklessly failed to make the appropriate retailers' occupation tax payments.' " *Id.* (quoting *Department of Revenue v. Marion Sopko, Inc.*, 84 Ill.App.3d 953, 955, 40 Ill.Dec. 487, 489, 406 N.E.2d 188, 190 (2d

Dist.1980)). Based upon the evidence that the Debtor has merely failed to respond to the Department's notice, the Court is unable to conclude that the Debtor's failure to pay the tax was willful or voluntary, conscious and intentional.

VI. *CONCLUSION*

For the reasons set forth herein, the Court hereby sustains the Trustee's objection to the allowance of the Department's subject proof of claim, as amended.

This Opinion serves as findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

MEMORANDUM OPINION

This matter comes before the Court on the motion for reconsideration filed by the Illinois Department of Revenue (the "Department") of the Court's Memorandum Opinion and Order dated November 25, 1992, and the response in opposition filed by Thomas E. Raleigh, Chapter 7 Trustee (the "Trustee"). For the reasons set forth herein, the Court hereby denies the motion.

I. *JURISDICTION AND PROCEDURE*

The Court has jurisdiction to entertain this matter pursuant to 28 U.S.C. § 1334 and General Rule 2.33(A) of the United States District Court for the Northern District of Illinois. This matter constitutes a core proceeding under 28 U.S.C. § 157(b)(2)(B).

II. *APPLICABLE STANDARDS*

"Motions to reconsider" are not formally designated by either the Federal Rules of Bankruptcy Procedure or Federal Rules of Civil Procedure, except as provided in 11 U.S.C. § 502(j) and Bankruptcy Rule 3008 which allow reconsideration of orders allowing or disallowing claims against the estate. Section 502(j) provides in relevant part that "[a] claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim may be allowed or disallowed according to the equities of the case." 11 U.S.C. § 502(j). Bankruptcy Rule 3008, in turn, provides that "[a] party in interest may move for reconsideration of an order allowing or disallowing a claim against the estate. The court after a hearing on notice shall enter an appropriate order." Fed.R.Bankr.P. 3008. Reconsideration of both allowed and disallowed claims may be made at any time before the case is closed. *In re Resources Reclamation Corp.*, 34 B.R. 771, 773 (Bankr.9th Cir.1983). The Court should weigh the extent and reasonableness of any delay, prejudice to the debtor and other creditors, effect on efficient administration, and the moving creditor's good faith. *Id.* Rule 3008 has been held permissive and does not require that a party file a motion to reconsider before appealing. *Walsh Trucking Co. v. Insurance Co. of North America*, 838 F.2d 698 (3rd Cir.1988).

The Seventh Circuit Court of Appeals has instructed courts to treat all substantive post-judgment motions filed within ten days of judgment under Rule 59. *Charles v. Daley*, 799 F.2d 343 (7th Cir.1986). Motions made thereafter are considered under the provisions of Rule 60 of the Federal Rules of Civil Procedure, as adopted by Bankruptcy Rule 9024. Because the motion at bar was filed and

served on December 4, 1992, within ten days of the judgment, the procedural standards and authorities construing section 502(j) and Rules 59, 3008 and 9023 control.

Motions made under Rule 59 serve to correct manifest errors of law or fact, or to consider the import of newly discovered evidence. *Publishers Resource, Inc. v. Walker-Davis Publications, Inc.*, 762 F.2d 557 (7th Cir.1985); *Keene Corp. v. International Fidelity Ins. Co.*, 561 F.Supp. 656 (N.D.Ill.1982), *aff'd*, 736 F.2d 388 (7th Cir.1984); *F/H Industries, Inc. v. National Union Fire Ins. Co.*, 116 F.R.D. 224, 226 (N.D.Ill.1987). The function of a motion made pursuant to Rule 59(e) is not to serve as a vehicle to relitigate old matters or present the case under a new legal theory. *Federal Deposit Ins. Corp. v. Meyer*, 781 F.2d 1260, 1268 (7th Cir.1986); *Evans, Inc. v. Tiffany & Co.*, 416 F.Supp. 224, 244 (N.D.Ill.1976); *In re BNT Terminals, Inc.*, 125 B.R. 963, 976-977 (Bankr.N.D.Ill.1990). The purpose of a motion to alter or amend "is not to give the moving party another 'bite at the apple' by permitting the arguing of issues and procedures that could and should have been raised prior to judgment." *BNT Terminals*, 125 B.R. at 977. "A motion brought under Rule 59(e) is not a procedural folly to be filed by a losing party who simply disagrees with the decision; otherwise, the Court would be inundated with motions from dissatisfied litigants." *Id.*

III. *THE DEPARTMENT'S ARGUMENTS*

The Department makes several arguments in its motion. First, it contends that Bankruptcy Rule 3002(c) conflicts with 11 U.S.C. § 726(a)(2) and (a)(3), the statutory provision governing payments of claims, because it

specifically contemplates allowance of late-filed claims by providing for their payment. Second, the Department argues that pre-petition unsecured priority claims that would be so classified under 11 U.S.C. § 507(a)(7), even if late-filed, such as the claim at bar, are entitled to payment and distribution along with timely filed pre-petition unsecured claims under section 726(a)(1). This is so, the Department maintains, because the text of section 726(a)(1) makes no reference to effectively subordinated dividend distributions of late-filed priority claim; section 726(a)(2) is explicitly inapplicable to priority claims by its text; and the provisions of section 726(a)(3) likewise do not specifically exclude claims that would otherwise be accorded administrative priority under section 507. Only claims of general unsecured creditors who file late claims receive distribution under section 726(a)(3).

Next, the Department urges the Court to follow the recent opinion of Judge Wedoff in *In re Rago*, 149 B.R. 882 (Bankr.N.D.Ill.1992) which followed *In re Hausladen*, 146 B.R. 557 (Bankr.D.Minn.1992). *Hausladen* held that late filing of a claim is not grounds for its disallowance under section 502(b). *Rago*, in turn, held that priority claims, even though late filed, are entitled to distribution under section 726(a)(1). The Department concludes that these two opinions are recent significant changes in extant case law concerning contested late claims allowance and payment, and the Court should follow these decisions by holding Bankruptcy Rule 3002(c) invalid as in conflict with sections 502(b) and 726. The Department concludes that because section 726(a)(2)(C) and (a)(3) provide for

payment of late-filed claims, they conflict with and override the provisions of Bankruptcy Rule 3002(c), notwithstanding the Seventh Circuit cases which do not address the perceived conflict, but assume the validity of the Rule. The Department contends that in the Chapter 7 context, there is no legal dispute that late claims are allowed. The real issue is classification for distribution purposes.

Lastly, concerning the merits of the underlying claim, the Department argues it established and proved a prima facie case, notwithstanding the Trustee's evidence and objections thereto, citing as supporting authority two Illinois Appellate Court decisions: *Quincy Trading Post, Inc. v. Department of Revenue*, 12 Ill.App.3d 725, 298 N.E.2d 789 (4th Dist.1973) and *Department of Revenue v. Corrosion Systems, Inc.*, 185 Ill.App.3d 580, 133 Ill.Dec. 647, 541 N.E.2d 858 (4th Dist.1989). The Court notes that it discussed and applied *Corrosion Systems* in its prior Opinion. Under this argument, the Department asserts that because the Trustee did not show that the Debtor was not a responsible officer, and there were no similar opinion letters of counsel on the non-taxable nature of the subject transaction issued to the purchasing corporation or its officers, or that the Debtor ever relied on the legal opinion that was given to the lender on the transaction, the Department's evidence is sufficient to support allowance of the underlying claim on its merits. The Department concludes that the Trustee had the burden of proving that the Debtor's failure to pay the claimed tax was not willful, rather than on it to show that the Debtor's failure to pay was willful.

IV. *THE TRUSTEE'S ARGUMENTS*

The Trustee counters with numerous arguments in opposition to the Department's motion. First, the Trustee notes that the motion does not show that the Court made any manifest error of fact or law, nor is the Department proffering any newly discovered evidence. Second, the Trustee counters that the Department's motion raises a new argument under *Rago* – that a tardily-filed proof of claim cannot serve as a basis for disallowance of a claim – which was not urged at the time of trial, and is not properly advanced under Rule 59. Third, the Trustee points out that the Court in its Opinion had considered the *Hausladen* view and rejected same for reasons stated therein. Fourth, the Trustee asserts that notwithstanding *Hausladen*, the analysis contained in *Rago* is flawed, and has effectively been rejected in *In re Unroe*, 937 F.2d 346 (7th Cir.1991) and *In re Stavriotis*, 977 F.2d 1202 (7th Cir.1992). As additional authority the Trustee cites *Wilkens v. Simon Bros., Inc.*, 731 F.2d 462 (7th Cir.1984) (per curiam) in which the Seventh Circuit noted that both the text of the Bankruptcy Code and the Bankruptcy Rules must be considered in determining whether a claim is to be disallowed. *Wilkens* looked to the Rules then in effect under the prior Bankruptcy Act in holding that a Chapter 13 claim was required to be filed no later than six months after the initial creditors' meeting.

The Trustee thus urges the Court to adhere to its view that the text of section 502(b)(1) effectively provides for disallowance of late claims as "unenforceable" under "applicable law" which the Court found included the time limits of Bankruptcy Rule 3002(c). Next, the Trustee contends that the *Rago* analysis would not be applicable

here under the facts of this matter because the Department's subject claim was asserted to be an amendment to previously timely claims, rather than a new claim, merely tardily-filed, unlike the claimant in *Rago* which had no notice of the case or its claim prior to the expiration of the claims bar date. Hence, the Trustee maintains that the Department cannot now, on its motion for reconsideration, argue that the subject tardily-filed proof of claim constitutes an entirely new claim, rather than an amended claim previously argued.

The Trustee further asserts that properly applied principles of statutory construction compel relegation of the Department's tardily-filed claim to payment and classification under section 726(a)(3) and (a)(4). On this point, the Trustee argues that section 726(a)(3) is for unsecured claims which are tardily-filed, and are not of a type specified in section 726(a)(2)(C), such as the Department's claim at bar, except the portion thereof which is a claimed penalty which would be more properly classified under section 726(a)(4). Consequently, the Trustee concludes tardily-filed unsecured claims, whether entitled to priority treatment under section 507 or not, do not require treatment and payment under 726(a)(1). The text of the various subsections comprising section 726 which contains enumerations of specific exclusions from various subparagraphs, is indicative that section 726(a)(3) should apply to all cases involving late claim payments not specifically excluded.

An additional point argued by the Trustee is that by extending the result reached in *Rago* to this case, havoc is wreaked on dividend payments. Affording late priority claims with an equal treatment to timely-filed allowed

claims, notwithstanding established claims bar dates, forces objecting debtors, trustees and other interested parties to thereafter institute subordination actions against tardily-filed claims pursuant to 11 U.S.C. § 510. In this regard, the Trustee argues that if the Court follows the *Rago* result, then principles of equitable subordination should be applied here to equitably subordinate payment of any part of the Department's claim it favorably reconsidered because here, unlike the tax claimant in *Rago*, the Department knew of this case and filed several timely claims. Lastly, on the merits on the underlying claim, the Trustee contends that the motion merely challenges the Court's factual finding that there was no supporting evidence showing that the Debtor willfully failed to pay the claimed tax assessed. Such a challenge to the Court's factual findings cannot be appropriately made on a motion for reconsideration.

V. *DISCUSSION*

One crucial point to emphasize is that the process of bankruptcy claim allowance or disallowance pursuant to the provisions of section 502(b) and Bankruptcy Rules 3007 and 3008 is a separate and distinct aspect of estate administration from the related process of payment. Allowed claims are paid through distributions from the bankruptcy estate, as defined in section 541, made by the Trustee pursuant to section 704 and Bankruptcy Rule 3009, through the provisions of, and in the priorities established under, section 726. Frequently, these two separate, but related, steps of claim allowance and claim payment practically occur in close proximity. The real issue here, however, involves the disallowance of the

Department's claim under section 502(b)(1) and Bankruptcy Rule 3002(c), not any claim classification issues for distribution purposes under section 726 as the parties unnecessarily argue for the first time in this motion. Only claims allowed under sections 501, 502, 503 and 507, and not disallowed under section 502(b), receive distributions under the priorities established in section 726. Because the Department's claim was disallowed both as untimely and on the merits, section 726 classification issues are irrelevant and immaterial to the claim disallowance issues.

For purposes of this contested matter, one ultimate issue is whether the Court's prior ruling disallowing the Department's claim pursuant to Bankruptcy Rule 3002(c) violates section 502(b)(1) of the Code, and secondly whether the Court's ruling disallowing the Department's claim on the merits was in error. After carefully considering and reconsidering the arguments, and with all due respect to the learned decisions in *Hausladen* and *Rago*, the Court disagrees with those conclusions that Bankruptcy Rule 3002(c) conflicts with section 502(b)(1). Neither opinion discusses or focuses on the operative language in section 502(b)(1). As previously stated in the Court's Opinion, the plain meaning of section 502(b)(1) provides for disallowance of a contested claim, if same is unenforceable against the Debtor for *any* reason other than because it is contingent or unmatured. This reading of section 502 and the end result is supported by its sparse legislative history. *See* H.R.Rep. 595, 95th Cong. 1st Sess. 352 (1977); S.Rep. 989, 95th Cong.2d Sess. 62 (1977) U.S.Code Cong. & Admin.News pp. 5787, 5848, 6308. There is no limit either in the text of section 502(b)(1) or

its legislative gloss which precludes resort to the statute of limitation created by Rule 3002(c) as appropriate applicable law.

In the Rules Enabling Act, 28 U.S.C. § 2075, Congress empowered the Supreme Court of the United States to prescribe rules for the practice and procedure in cases under Title 11. Section 2075 expressly provides that such rules shall not abridge, enlarge or modify any substantive right. Accordingly, it has been held that the rule making power of the Supreme Court is limited and to be exercised consistently with the substantive provisions of Title 11. *In re Itel Corp.*, 17 B.R. 942 (Bankr.9th Cir.1982). Rules promulgated pursuant to section 2075 have the force of law pursuant to that authority granted by Congress. *In re Brooks Fashion Stores, Inc.*, 124 B.R. 436, 440 (Bankr.S.D.N.Y.1991). The bankruptcy court is bound to follow, without exceptions, the rules promulgated by the United States Supreme Court unless a rule is inconsistent with the statute, in which case the Bankruptcy Code controls over inconsistent procedural rules. *In re Wilferth*, 57 B.R. 693, 694 (Bankr.D.N.M.1986). Rules are entitled to a presumption that they were promulgated within the proper authority of the Supreme Court and do not affect substantive rights. *In re Neese*, 87 B.R. 609, 611 (9th Cir.BAP 1988). A party contending that a court rule violates substantive rights bears a heavy burden of proof. *Neese*, 87 B.R. at 611; *In re Management Data Services, Inc.*, 43 B.R. 962, 966 (Bankr.W.D.Wash.1984). The Court concludes that the operative text of section 502(b)(1) can be harmoniously construed and applied through the statute of limitations provided by Bankruptcy Rule 3002(c).

The Court rejects the Department's argument that Bankruptcy Rule 3002(c) patently conflicts with the distribution scheme of section 726. In bankruptcy estates where there is sufficient money or other liquidated assets to pay allowed priority claims that have been filed under section 726(a)(1), then after all claims at that distribution level under section 726 have been paid in full, to the extent there are additional estate funds on hand to pay claims that fall under section 726(a)(2), those proceeds are distributed pro rata to claim holders falling in that class. If there are sufficient funds on hand to fully pay all claimants in that class of claims, the excess is then distributed down to the section 726(a)(3) level of tardily-filed claims. Although infrequent, occasionally there are bankruptcy estates in which there are sufficient funds to pay all claims timely and tardily-filed leaving an excess to cover payment of penalty, fines or punitive damage claims under section 726(a)(4). If those claims are all paid in full, then distribution of post-petition interest is paid to allowed claim holders under section 726(a)(1)-(4) pursuant to section 726(a)(5). Thereafter, any surplus of the estate is to be paid to the debtor pursuant to section 726(a)(6). In such cases, there is no need for a trustee to object to late claims because there is enough to pay all claims.

In the vast majority of Chapter 7 estates, however, like the case at bar, there are insufficient assets to pay all allowed claims that are timely filed whether priority under section 726(a)(1), or unsecured under section 726(a)(2)(A). It is precisely in cases such as this, where there are not enough assets to pay all claim holders, that

the impact of Bankruptcy Rule 3002(c) becomes important. It is not logical to extend the first priority in distribution under section 726(a)(1) to tardily-filed claims because section 726(a)(2)(A) and (B) provides that timely-filed allowed claims take priority over tardily-filed allowed claims under section 726(a)(2)(C) and (a)(3). Moreover, the Department's classification argument only impacts on allowed claims. This matter, however, focuses on its claim disallowed under 502(b)(1), rather than the distribution classification scheme under section 726. Therefore, it is unnecessary, for proper determination of this matter, to categorize the Department's claim under section 726, had it not been disallowed, nor address the equitable subordination arguments newly raised by the Trustee. The Court need not reach such subordination and classification issues discussed in *Rago*. Only allowed claims are entitled to receive distributions from the estate. Thus, the principal focus and discussion in *Rago* concerning section 726 is inapposite and not controlling in this matter.

The result reached here is also in accord with *United States v. Vecchio*, 147 B.R. 303 (E.D.N.Y.1992). There the bankruptcy court disallowed two claims of the Internal Revenue Service which were filed late. Similar to the tax claimant in *Rago*, the IRS in *Vecchio* argued that it should be entitled to section 726(a)(1) treatment. The district court on appeal held that the IRS's late claims should be relegated to section 726(a)(3) status, and same extends to all tardy claims, both priority and non-priority. *Id.* at 306. *Vecchio* cited with approval *In re Global Precious Metals, Inc.*, 143 B.R. 204 (Bankr.N.D.Ill.1992), which found that a creditor without notice is protected by section 726(a)(2),

but otherwise the ninety-day filing requirement of Bankruptcy Rule 3002(c) applies. *Vecchio* noted that judicial efficiency, certainty and finality with respect to bankruptcy proceedings would be severely hampered if creditors with priority claims were able to assert them at any time, regardless of having received timely notice of the bankruptcy proceeding. 147 B.R. at 307. The contrary view espoused in *United States v. Cardinal Mine Supply, Inc.*, 916 F.2d 1087 (6th Cir.1990), urged by the Department, is rejected. The *Vecchio* court concluded that a broad reading of *Cardinal Mine* does not subsume the Bankruptcy Rule 3002(c)(1) ninety-day deadline with regard to federal tax claims, it makes the Rule inapplicable, wherever a priority claim is allegedly asserted. 147 B.R. at 307. A creditor could appear years after receiving timely notice of the bankruptcy, and if his claim was a priority claim, it would be protected. That result is inequitable especially under the facts of this matter. The controlling law and equities of the case militate in favor of the Trustee's position, and against that taken by the Department.

On the merits of the underlying claim and the objection thereto, there was no evidence furnished at trial that the Debtor's failure to pay the subject claim was willful. Contrary to the Department's arguments, the Department had the burden of proof to show the Debtor's failure to pay the subject claim was willful, rather than the Trustee, as the objector, having the burden to show that the Debtor's failure to pay was not willful. No evidence was adduced by the Department to show that the Debtor's failure to pay the claimed tax was a voluntary, conscious and intentional failure as required by the controlling

holding in *Department of Revenue v. Heartland Invest., Inc.*, 106 Ill.2d 19, 30, 86 Ill.Dec. 912, 476 N.E.2d 413 (1985). The other case cited by the Department, *Quincy Trading Post*, did not involve assessment of a tax liability against a responsible corporate officer under 35 ILCS 120/13 1/2, and is therefore inapposite and not on point.

A recent opinion of the Seventh Circuit dealing with contested bankruptcy claims provides instructive dicta: "[e]nforcing the Bankruptcy Rules according to their terms cannot be an abuse of discretion." *In re Danielson*, 981 F.2d 296, 299 (7th Cir.1992). Although *Danielson* did not decide the issues raised here, it expressly references Bankruptcy Rule 3002(c), noting that the Seventh Circuit regularly holds that sloth, ignorance or other negligence does not qualify as excusable negligence warranting enlargement of time under Bankruptcy Rule 9006(b)(1). *Id.* at 298. *Danielson* cites *Unroe* with approval and *Taylor v. Freeland & Kronz*, ___ U.S. ___, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992), which noted that courts have no standby power to excuse violations of statutes and rules. In addition, in *Holstein v. Brill*, 987 F.2d 1268 (7th Cir.1993), the court, in discussing amendments to claims, noted: "[l]eave to amend should be freely granted . . . but passing milestones in the litigation make amendment less appropriate. One milestone of particular significance in bankruptcy is the bar date." *Id.* 987 F.2d at 1270.

VI. *CONCLUSION*

For the foregoing reasons, the Court hereby denies the Department's motion for reconsideration.

This Opinion serves as findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

No. 99-387

(2)

Supreme Court, U.S.
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In The

Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee for Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF *AMICUS CURIAE* FOR THE STATES OF NEW MEXICO, CALIFORNIA, MONTANA, NORTH DAKOTA, OHIO, OKLAHOMA, OREGON, SOUTH DAKOTA AND VERMONT IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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The *amici curiae* states, through their undersigned attorneys general, respectfully submit this brief in support of Thomas J. Raleigh's petition for certiorari.

INTEREST OF *AMICI CURIAE*

One of the primary law enforcement responsibilities of state government is ensuring that citizens comply with state tax laws. The decision below should be reviewed and affirmed in order to eliminate the conflict with several other decisions that significantly, unfairly and erroneously hamper the enforcement of those laws.

At issue is whether a taxpayer who has the burden of proof under state law can switch the burden to the government by filing for bankruptcy. This is not a rare or unusual situation. Approximately 1.4 million bankruptcies are filed annually in the United States. An enormous amount of tax revenues are subject to the review and control of the bankruptcy courts.

On several occasions, this Court has noted that burden of proof is an issue of substantive law. It will often determine the prevailing party in a legal proceeding. In the tax context, the rule of requiring the taxpayer to bear the burden of proof is essential and promotes the policies of tax administration. The alternative of requiring the government to disprove a claimed deduction of the taxpayer, for instance, would not only be impractical, it would seriously undermine the companion laws requiring taxpayers to keep adequate documentation. Moreover, the government's relative lack of knowledge of the

particulars of the taxpayer's financial affairs makes placing the burden of proof on the taxpayer necessary and eminently fair. If the burden is placed on the government in bankruptcy cases, it will result in forum shopping and substantial losses of much-needed tax revenue.

SUMMARY OF ARGUMENT

1. The court below correctly determined that in a bankruptcy proceeding the party seeking to refute the tax assessment has the ultimate burden of proving its claim. The court succinctly stated that "bankruptcy is not a 'free for all balancing act.' " *In re Stoecker*, 179 F.3d 546, 551 (7th Cir. 1999) (citation omitted). The Seventh Circuit's decision to apply the state law burden of proof to Illinois' tax claim is wholly consistent with both federal statutory and common law and with this Court's decisions. *See* 28 U.S.C. § 1652 (state law provides the "rules of decision in civil actions" in which state law is decided in federal court); *Butner v. United States*, 440 U.S. 48 (1979) (Unless Congress specifically states otherwise, the basic rule in bankruptcy is that state law determines the substantive rights of the parties). Moreover, the decision below is in harmony with Congress' intent that these tax claims be paid as shown by the priority and exception from discharge afforded those claims. However, as the petitioner correctly points out to the Court on page 6 of his petition, five different courts of appeal, and many other lower courts, have reached the opposite conclusion; the decision below, on the other hand, is consistent with two other courts of appeal and various lower courts.

2. If the opinion of the court below is not reviewed and affirmed by this Court, and the numerous contrary opinions were left to stand, the majority of circuits would continue to administer a rule of law which seriously disrupts the administration of tax laws by placing on governmental entities an unfair burden that does not exist outside bankruptcy courts. Because the burden of proof is more beneficial to taxpayers in some circuits' bankruptcy courts than in the state courts on tax matters, the bankruptcy courts in those circuits will often reach a different conclusion than the state courts on the ultimate issue of liability. Such result is directly contrary to the doctrine of comity and federalism with regard to state law determinations in federal courts. *See Erie Railroad Co. v. Tomkins*, 304 U.S. 64 (1938). Moreover, since the bankruptcy forum has been rendered more favorable for taxpayers in some circuits than the non-bankruptcy forum, the continued split of authority will engender forum shopping, both between bankruptcy courts and state courts and between bankruptcy courts in some circuits and bankruptcy courts in other circuits.[1] The result will "funnel people with tax problems into the bankruptcy courts, and thus undermine the enforcement of state tax

[1] Bankruptcy venue can be manipulated. 28 U.S.C. § 1408(1) provides that state of incorporation is an appropriate venue and § 1408(2) provides that venue is appropriate where the bankruptcy case of a partner, partnership or affiliate is pending. A venue shopper merely has to incorporate an affiliate in the jurisdiction of the desired bankruptcy court, put the affiliate in bankruptcy, and then file all other affiliates or partners in that jurisdiction.

law." *Thinking Machines v. New Mexico Taxation and Revenue Department*, 211 B.R. 426, 431 (D. Mass. 1997).

ARGUMENT

Three years ago, the Court was asked to take certiorari in the case of *In re Macfarlane*, 83 F.3d 1041 (9th Cir. 1996) *cert. denied* 520 U.S. 1115 (1997) in order to resolve this split of authority. While the Court ultimately decided that *Macfarlane* was not the vehicle through which to resolve this dispute, the split of authority remains and has continued to recur. The opinion below is well-suited for certiorari review to eliminate this conflict.

In *Macfarlane*, the Ninth Circuit Court of Appeals, in an opinion directly contrary to the one below, ruled that the ultimate burden of proof is switched to a taxing authority if the claim is litigated in bankruptcy court, whereas outside of bankruptcy the taxpayer generally carries the burden. Twenty-four states filed an *amici curiae* petition asking the Court to grant certiorari in that case. The Court invited the Solicitor General to file an *amicus* brief. *Macfarlane v. California Franchise Tax Board*, 519 U.S. 925 (1995). The Solicitor General's brief agreed with *amici* States, regarding the importance of the issue and the need for review. However, the Solicitor General advised the Court that the case was not an appropriate vehicle for resolving this important issue because the Ninth Circuit did not have proper jurisdiction of the case in that the court had assumed jurisdiction over an interlocutory matter pursuant to the statute governing appeals of final judgments. Perhaps agreeing with the Solicitor General

on the jurisdictional issue, the Court denied certiorari on March 17, 1997. There does not appear to be any potential jurisdictional problem in the Seventh Circuit's opinion below.

In this case, the state of Illinois imposed a use tax on a responsible officer (the president) of a corporation relating to the purchase of an airplane, and filed a proof of claim in the bankruptcy court for the tax assessment against the officer ("Stoecker"). Under Illinois law, Stoecker had the burden of proof. The trustee for Stoecker's estate objected to the claim. In light of the fact that Stoecker was under criminal indictment for federal bank fraud,[2] and was taking the Fifth Amendment in response to discovery, neither the state of Illinois nor the trustee could adequately prove nor disprove Stoecker's willfulness with regard to the corporation's non-payment of the use tax with respect to the purchase of the $12 million airplane. The airplane's purchase was never reported on any tax forms provided to the state, nor was the airplane ever registered with the state as required by state statute. The court below correctly noted that "the burden of proof [was] critical" to the outcome. 179 F.3d at 551. The bankruptcy court and district court ruled that the burden of proof was switched to Illinois due to the litigation occurring in bankruptcy court, and entered judgment for the trustee. The court below reversed, and ordered that judgment be entered for the state.

The Bankruptcy Code does not address the issue of burden of proof when claims are litigated in bankruptcy

[2] *In re Stoecker*, 202 B.R. 429, 458-59 (Bankr. N.D. Ill. 1996).

court. In the most general terms possible, Congress has stated only that, "if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency. . . . " Code § 502(b). Similarly, Code § 505(a)(1) permits the court to "determine the amount or legality of any tax. . . . " Bankruptcy courts are units of the United States district courts. 28 U.S.C. § 151. The Rules of Evidence apply in the bankruptcy courts. Federal Rule of Evidence 101.

Under 28 U.S.C. § 1652, the state law provides the rules of decision in cases where state law is to be determined in federal court. As a general, and well recognized, matter of tax law the ultimate burden of persuasion is placed on the taxpayer. *E.g., See Stohr v. New Mexico Bureau of Revenue*, 90 N.M. 43, 559 P.2d 420 (Ct. App. 1976).[3] Although the tax at issue in the instant case is a use tax, the law is generally the same with regard to other state revenue sources, such as sales, gross receipts and excise taxes. *See*, NMSA § 7-9-5 (receipts from engaging in business in New Mexico presumed taxable). Federal Rule of Evidence 301 provides that the ultimate burden of persuasion "remains throughout the trial upon the party

[3] *See also, e.g.*, N.C. Gen Stat. § 105-164.26 (presumed that all receipts of wholesalers and retailers are subject to sales tax); *Ward v. Clayton Comm'r of Revenue*, 5 N.C. App. 53, 60, 167 S.E. 2d 809 (1969), *aff'd*, 172 S.E.2d 531 (taxpayer has the burden of proving deductions); N.J.S.A. §§ 54:32B-12(b) (all sales presumed taxable), 54A:9-9(e) (taxpayer has burden of proof with certain exceptions); Iowa Code § 421.60(6) (Code Supp. 1995) (taxpayer has the burden of proof); *Patterson v. Heitkamp*, 442 N.W.2d 219 (N.D. 1989) (taxpayer has burden of proof); *Appeal of Net Realty Holding Trust*, 128 N.H 795 (1986) (taxpayer has the burden of proof).

on whom it was originally cast." Rule 302 provides that the effect of any presumption arising under state law is to be determined by state law.

Acknowledging that its opinion was directly contrary to *Macfarlane, supra*, the court below ruled that the trustee had the burden of proof because that is the rule under Illinois law. 179 F.3d at 552. There is a direct conflict among the circuits and in the lower courts as the petitioner accurately states. Because of this conflict and because the contrary result of many courts impairs state tax collections and transform the bankruptcy courts into the preferred forum for state and federal taxpayers to obtain a favorable determination of tax disputes,[4] the Court should grant certiorari.

I. THE COURT SHOULD GRANT CERTIORARI BECAUSE OTHER CIRCUITS HAVE REACHED CONTRARY DECISIONS WHICH CONFLICT WITH THE UNDERLYING PRINCIPLES OF *BUTNER V. UNITED STATES*, 440 U.S. 48 (1979) AND 28 U.S.C. § 1652 AND WITH CONGRESS' GRANTING STATUTORY PRIORITY TO TAX CLAIMS

The decision below is in harmony with the long-standing principle that non-bankruptcy law governs the rights of creditors. As this Court has noted time and time

[4] There is nothing preventing a debtor from filing a bankruptcy petition for no other reason than to obtain a favorable forum to litigate a tax problem. Code § 1307(b) provides a Chapter 13 debtor the absolute, non-waiveable, right to dismiss a bankruptcy petition, which the debtor could do subsequent to litigating his tax dispute.

again, burdens of proof are part of the substantive law of the state. *E.g., Dick v. New York Life Ins. Co.*, 359 U.S. 437 (1959); *Palmer v. Hoffman*, 318 U.S. 109 (1943); *Cities Service Oil Co. v. Dunlap*, 308 U.S. 208 (1939). Consistent with those cases, this Court has ruled that when a federal claim is tried in state court, the state court must apply the federal law burden of proof, noting it "was a part of the very substance of his claim and cannot be considered a mere incident of procedure." *Garrett v. Moore-McCormack Co.*, 317 U.S. 239, 248-49 (1942). *See also, Director, OWCP v. Greenwich Collieries*, 512 U.S. 267, 271 (1994).

This Court has long held that the converse is equally true in the bankruptcy courts when they apply state law in the federal arena. "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner v. United States*, 440 U.S. 48, 55 (1979). The Court noted that the "basic rule" in bankruptcy proceedings "is that state law governs." *Id.* at 57. "What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed, is a question which, in the absence of overruling federal law, is to be determined by reference to state law." *Vanston Bondholders Protective Comm. v. Green, et al.*, 329 U.S. 156, 161 (1947). *See generally*, Alfred Hill, *Erie Doctrine in Bankruptcy*, 66 Harv. L. Rev. 1013 (1953) (cited with approval in *Butner*, 440 U.S. at 52 n.2).

Whether a liability exists is often determined by which party had the burden of establishing certain claims

or defenses, which is why that burden is considered "a part of the very substance of [the] claim." *Garrett*, 440 U.S. at 55. Debtors who are able to file bankruptcy in those circuits that switch the burden of proof for tax litigation, therefore, receive "a windfall merely by reason of the happenstance of bankruptcy." *Lewis v. Manufacturers National Bank*, 364 U.S. 603, 609 (1961). As was concisely stated by one bankruptcy court: "To rule [in favor of the taxpayer] would permit a tax litigant to shift the burden of proof to the [taxing authority] by filing bankruptcy." *In re Cobb*, 135 B.R. 640, 641 (Bankr. D. Neb. 1992).

The foundation upon which the contrary line of authority is built is a so-called "broad rule that taxing authorities are to be treated the same as other claimants *and must therefore bear the ultimate burden of proving their claims in bankruptcy.*" *Macfarlane, supra*, 83 F.3d at 1045 (emphasis added). The problem here is that, upon a careful analysis, there is no "broad rule" that all claimants "bear the ultimate burden of proving their claims in bankruptcy." Granted, it is *generally* true that claimants – as creditors and therefore the functional equivalent of plaintiffs under non-bankruptcy law[5] – usually bear the burden of proof in bankruptcy as they would outside of bankruptcy. However, in a variety of circumstances

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[5] *See In re Thinking Machines*, 203 B.R. 1, 2 (Bankr. D. Mass. 1996), *modified*, 203 B.R. 426 (D. Mass 1997) ("Courts routinely rule . . . that the ultimate burden of proof rests upon the claimant. This is intended to place the claimant in the same position it would have been had the claimant been a plaintiff in a civil action. The application of this rule is problematic when the claimant is a taxing authority.").

courts have had little difficulty ruling that where non-bankruptcy law places the burden of proof on the debtor, the debtor retains the burden of proof even in a claim objection proceeding or similar matter. *In re Unioil*, 962 F.2d 988, 994 (10th Cir. 1992) (since party seeking to prove an accord and satisfaction has the burden of proof under Colorado law, the debtor had the burden of proving an accord and satisfaction in a claim objection proceeding); *In re Andover Togs, Inc.*, 231 B.R. 521, 530-31 (Bankr. S.D.N.Y. 1999) (in an administrative claim objection proceeding, debtor/tenant had the burden of proving that provisions in the lease were unenforceable due to laches or equitable estoppel, because New York law places the burden of proving those issues on the party asserting them); *In re Farris*, 194 B.R. 931 (Bankr. E.D. Pa. 1996) (debtor had the same burden of proving likely Truth in Lending Act violation under non-bankruptcy federal law as any other party raising this defense); *In re El Paso Refining, Inc.*, 192 B.R. 144 (Bankr. W.D. Tex. 1996) (in claim objection proceeding in which debtor was a guarantor of a debt, court adopted non-bankruptcy caselaw and ruled that the debtor had the burden of proving that the debt between the creditor and the primary obligor had been satisfied); *In re Brummer*, 147 B.R. 552 (Bankr. D. Mont. 1992) (debtor had burden of proving debt was usurious under Montana law); *In re Biglari Import Export, Inc.*, 130 B.R. 43 (Bankr. W.D. Tex. 1991) (in claim objection proceeding, where creditor had seized collateral prior to the petition being filed, debtor had the burden of proving that the creditor did not exercise reasonable care with regard to repossessed collateral since Texas law put burden of proving this issue on the debtor); *In re Wills*,

126 B.R. 489, 497 (Bankr. E.D. Va. 1991) (summary judgment entered for creditor in claim objection proceeding because debtor had the burden of proving by clear and convincing evidence under Virginia law that contractual debt could be avoided on grounds of incapacity of the debtor at the time of signing the contract); *In re Woehr*, 121 B.R. 743 (N.D. Tex. 1990) (debtor had burden of proving debt usurious under Texas law); *In re Hood*, 95 B.R. 696, 702 (Bankr. W.D Mo. 1989) (debtor had the burden under Missouri law of proving that contract was entered into under duress); *In re Borum*, 60 B.R. 516 (Bankr. E.D. Ark. 1986) (debtor had the burden of proving usury under Arkansas law). *See also, In re Niles (Otto v. Niles)*, 106 F.3d 1456 (9th Cir. 1997) (state law that places burden of proof on fiduciary to properly account for funds held in trust was equally applicable in discharge action); *Thomson v. Boswell*, 166 F.2d 106, 108 (6th Cir. 1948) (in a railroad reorganization proceeding, the estate was liable in an accident involving a passenger vehicle on the train tracks because Arkansas law required the railroad operator to affirmatively prove that it maintained an adequate lookout). The above decisions reflect the proper respect for the substantive law applicable to these issues, as does the decision of the court below.

The real driving force of opinions like *Macfarlane*, is the concept that since tax liabilities receive certain priorities in bankruptcy court, the courts should make it more difficult to establish those liabilities than under applicable non-bankruptcy law. The *Macfarlane* court explained at 83 F.3d 1045: "Since tax claims already receive a statutory priority over other claims, relieving the Board of its burden of proof would be granting the Board a double

benefit. . . . " This reasoning is faulty. The *Macfarlane* court missed the point, when it discussed "relieving the Board of *its* burden of proof," that said burden of proof is one which courts have created to begin with and which does not exist under nonbankruptcy law. By fashioning its result as denying a "double benefit" or refusing to "relieve" the taxing authority of "*its* burden of proof," *Macfarlane* avoided the more accurate characterization of this ruling: creating equitable impediments for a certain class of creditors based upon the notion that Congress has given them too much. The court below accurately characterized the *Macfarlane* line of cases as "cut[ting] down the entitlements that creditors seek to enforce in bankruptcy," and "[a]n equity free-for-all [which] would engender confusion and uncertainty and increase the strategic incentives to petition for bankruptcy. . . . " 151 F.3d at 551.

As the court below recognized, this Court recently ruled that equity does not go so far as to permit an invasion by the courts into the legislative function. *U.S. v. Noland*, 517 U.S. 535, 539-541 (1996). There is simply no basis in law or logic for courts to eliminate one benefit which the law provides to a creditor because Congress has also provided the creditor with a different benefit. Indeed, if the court below had not reversed the district court, the decision would not have denied Illinois *only one* of its benefits. If the court below had ruled, as did the bankruptcy and district court, that *Stoecker* had no tax liability, the court would have made the priority and exception from discharge benefits which Congress provided to Illinois with respect to those types of taxes irrelevant.

In any event, the choice as to how to allocate benefits and detriments is up to Congress, not the courts. Indeed, in many respects, the Code provides *less* favorable treatment to the governmental taxing authority than under non-bankruptcy law. In state-court receivership proceedings, for instance, state and federal taxes are not paid eighth as they are under the bankruptcy code, Code § 507(a)(8), they are generally paid first. *N.M. College of Agric. & Mechanic Arts v. Academy of Aviation, Inc.*, 83 N.M. 86, 488 P.2d 343 (1971). Taxes can be, and indeed often are, discharged under the bankruptcy code unless they fall within a recognized exception. *See* Code §§ 523(a)(1) (providing an exception to discharge for some tax liabilities), 727(b) (providing that a chapter 7 discharges all debts not within a § 523 exception), 1328(a) (providing no exception to discharge for tax liabilities; tax liabilities completely dischargeable in chapter 13)[6] and 1141(d) (no exception to discharge for tax liabilities in Chapter 11 if debtor is a corporation). Tax liens can sometimes be subordinated, Code § 724(b) or avoided altogether, Code § 545. Certain state taxes can be barred by confirmation of a Chapter 11 plan, Code § 1146(c). However, in each of these situations, Congress has been very explicit as to the choice it has made.

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[6] Although Code § 1322(a)(2) requires that certain "priority" taxes (*e.g.*, trust fund taxes or recently incurred income taxes) must be paid in full over time without interest, reported cases to date have held that a confirmed plan may nevertheless eliminate even those taxes without any payment if a plan which purports to do so is confirmed or the taxing authority misses a proof of claim deadline. *See In re Tomlan*, 102 B.R. 790 (E.D. Wash. 1989), *aff'd*, 907 F.2d 114 (9th Cir. 1990) (collecting cases). *See also, In re Lee*, 184 B.R. 257 (W.D. Va. 1995).

The basis of taxation in this country, both at the state and federal level, is voluntary compliance, which involves requiring the taxpayer to accurately and honestly report his business transactions and to maintain and retain records substantiating his position in the event of any contest of the tax liability. One reason Congress has given a higher statutory priority to taxes than, for instance, debts owed to trade creditors, is that taxing authorities cannot choose to whom they extend credit and to whom the government extends services, let alone vary interest rates based upon the risk of default or the quality of the collateral. And unlike other involuntary creditors, such as tort claimants, there is seldom any insurance policy to which the government can resort to collect the involuntarily incurred debt. The reason for giving taxes some special protections in bankruptcy is clearly a reasoned judgment of Congress, and it should be respected. The opinion below does so and should be affirmed on that basis.

II. THE COURT SHOULD GRANT CERTIORARI BECAUSE THE CURRENT SPLIT OF AUTHORITY COULD WREAK HAVOC ON STATE TAX ADMINISTRATION AND PROMOTE FORUM SHOPPING IN TAX CASES

Cases frequently arise in bankruptcy court where an audit discovers unreported tax liability. If the taxpayer is in bankruptcy, he may make thinly-substantiated statements as to its expenses or as to the nature of its sales activity, and assert that the taxing authority has to disprove these assertions. As in the case below, disproving a taxpayer's assertions can be virtually impossible. In a

non-bankruptcy tax proceeding, taxpayers' assertions of fact that are not backed by documentation are given little weight. In many circuits' bankruptcy courts, however, assertions may be enough. The result is that in several circuits, the congressional protections given to tax liabilities in bankruptcy court are rendered illusory whenever there is any dispute as to the amount of those liabilities.

If Mr. Stoecker had been assessed and exercised his administrative remedies under Illinois law prior to filing bankruptcy, he would, of course, have been subject to the Illinois standards of proof. Whatever resulted from that proceeding would be binding upon the bankruptcy court. Code § 505(a)(2)(A). *See In re Trans State Outdoor Advertising Co.*, 140 F.3d 618 (5th Cir. 1998). The resulting liability would have been subject to the priority and discharge provisions of bankruptcy code. The opinion below eliminates the strategic incentive to file bankruptcy instead of exercising one's administrative remedies under substantive tax law. Unfortunately, other courts do provide such an incentive, because the more favorable burden of proof in some bankruptcy courts on tax issues will provide a more favorable forum for the taxpayer to litigate with the government as to the extent of their liability. This cannot be what Congress intended when it enacted the innocuous phrase "the court may determine the amount . . . of any tax" in Code § 505(a)(1). Indeed, the relationship between Code § 505(a)(1) (court may determine tax liability) and § 505(a)(2)(A) (court may not determine tax liability if the tax was contested in a judicial or administrative proceeding prior to bankruptcy) would lead to the ordinary conclusion that Congress intended that there

should be no difference in the analysis or the outcome when taxes are litigated in bankruptcy.

Moreover, it is doubtful that Congress intended the anomalous situation in which the very same claim adjudication proceeding would be subject to different burdens of proof depending upon whether the bankruptcy court abstained from hearing the proceeding and deferred to a state adjudication, which the law permits in some circumstances and requires in other circumstances. *See* 28 U.S.C. § 1334(c).[7]

The ruling below, that a court should not interpret federal law as creating equitable impediments to state tax law, is directly supported by this Court's precedent. In *National Private Truck Council, Inc. v. Oklahoma Tax Commission, et al.*, 515 U.S. 582 (1995), the Court noted that federal laws must be construed against "the background presumption that federal law generally will not interfere with administration of state taxes. . . . " *Id.*, at 588. The Court noted that "Congress and [the Supreme Court] repeatedly have shown an aversion to federal interference with state tax administration." *Id.*, at 586. In the bankruptcy context, this Court has referred to 28 U.S.C. § 960, although not directly applicable in that particular proceeding, as indicating "a Congressional purpose to

[7] Under the doctrine enunciated by some courts, such as *Macfarlane*, a debtor could oppose an abstention motion on the basis that the debtor is more likely to lose in a state proceeding! Such a rationale, while absurd, seems to be dictated by the *Macfarlane* court's decision based upon the purported "policy considerations that underlie the bankruptcy code," 83 F.3d at 1045.

facilitate – not to obstruct – enforcement of state laws." *Cal. Bd. of Equalization v. Sierra Summit*, 490 U.S. 844, 852-53 (1989). In *Sierra Summit*, the Court reversed the Ninth Circuit which ruled that bankruptcy sales were not subject to state sales tax. The court of appeals had ruled that since 28 U.S.C. § 960 did not specifically make the sales subject to tax, federal bankruptcy principles of equity required that they not be taxed. The Supreme Court ruled that the court of appeals erred in ruling that the existence of one statute benefiting state taxes indicated that all other legal benefits in bankruptcy court were implicitly eliminated. The Court concluded that "[i]f Congress wished to declare otherwise, its intent would have to be 'clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt.' " *Id.*, at 854. *Compare Macfarlane*, 83 F.3d at 1045 ("In the absence of statutory directive, we consider it appropriate to turn to policy considerations that underlie the bankruptcy code.") *with Stoecker*, 179 F.3d at 552 ("Congress can alter the entitlements in bankruptcy, and sometimes does so, but there is no indication that it meant to shift the burden of proof from taxpayer to tax collector. Rather the contrary . . . [T]he close attention that the drafters of the Code paid to issues of burden of proof [in other instances] makes their silence on the burden of proof in tax cases eloquent.").

CONCLUSION

For all of the foregoing reasons, *amici* States respectfully request that the Court grant certiorari in this case.

Respectfully submitted,

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(3)

No. 99-387

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In the

Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee for Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the Seventh Circuit correctly held—in agreement with the only other court of appeals to have thoroughly analyzed the question—that Congress has not seen fit in the Bankruptcy Code to shift the burden of proof to the government on tax claims, a burden that substantive tax law ordinarily places on taxpayers, when the government brings tax claims in the bankruptcy court.

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STATEMENT OF THE CASE

1. Chandler Enterprises and Stoecker

Chandler Enterprises, Inc., was an Illinois corporation, and William J. Stoecker was its president and one of its directors. Chandler's officers included one Lawrence Pluhar, who also served as an officer of other corporations involving Stoecker. According to Chandler's counsel, Pluhar acted "like his [Stoecker's] chief financial officer." Other than that single comment, though, there is no evidence of the duties Stoecker or Pluhar performed for Chandler. Nor is there any evidence of the nature of Chandler's business. Chandler was involuntarily dissolved in 1990.

In 1989, Stoecker's creditors initiated an involuntary proceeding against him under chapter 11 of the Bankruptcy Code. The proceeding was later converted to a liquidation under chapter 7. In 1990, Stoecker was denied a discharge.

Chandler was just one of many corporations in a corporate empire that revolved around Stoecker. A federal grand jury later indicted Stoecker and Pluhar on numerous counts of mail, wire and bank fraud in connection with these companies. The indictment alleged that many of the Stoecker companies—including Chandler—were shells, having no substantial assets, value, income, or business operations. Stoecker and Pluhar were eventually convicted on a superseding indictment. *See United States v. William Stoecker, et al.*, No. 95 CR 118 (N.D. Ill. March 4, 1997). The case is on appeal, captioned *United States v. William Stoecker, et al.*, No. 97-3870 (7th Cir.).

2. Chandler's Purchase of the Aircraft

In early 1988, Chandler became interested in purchasing a corporate jet. Chandler hired Jack Prewitt & Associates ("JPA"), an aircraft broker, to locate an aircraft for sale, and JPA found a Dassault Falcon 50 in the possession of Bezwada Investments Pty. Ltd., an Australian company. Chandler entered into an "Exclusive Purchase Agreement" with JPA under which JPA would serve as broker for the sale.

Although Chandler intended to purchase the aircraft outright, when the time came Chandler was unable to pay the full purchase price. Prewitt Leasing, Inc., a corporation related to JPA, offered to finance the sale. On June 7, 1988, Chandler accordingly entered into an "Aircraft Lease/Purchase Agreement" with Prewitt Leasing. Stoecker signed the Agreement as Chandler's president. Chandler paid Prewitt Leasing $2,455,016, agreed to pay an additional $10 million plus interest upon "closing," and took delivery of the aircraft. The aircraft entered Illinois on June 7, 1988.[1]

Some months later, Chandler obtained financing from NEMLC Leasing Corporation to pay the balance of the purchase price. On September 30, 1988, Chandler entered into an "Aircraft Purchase Agreement" with Prewitt Leasing that was signed by Pluhar as assistant

[1] The Trustee states that the only evidence the Department had linking Stoecker to the affairs of Chandler was Stoecker's position as one of Chandler's officers and directors. (Pet. at 3-4). In fact, Stoecker was also involved in the purchase of the aircraft, signing the Agreement himself. (Bankruptcy Record ("B.R.") vol. 4, Prewitt Dep. Ex. 3).

secretary of Chandler. Chandler paid Prewitt Leasing the balance of the purchase price, and title to the aircraft was transferred to Chandler.[2]

In connection with the closing, NEMLC sought a legal opinion from Chandler concerning the taxability of the transaction under Illinois law. Chandler's counsel prepared a letter dated September 30, 1988, in which he opined that the sale was an "occasional sale" not subject to Illinois use tax. (B.R. 1992 Tr., Trustee Ex. 3). The opinion letter was sent to NEMLC, a copy was sent to Pluhar, and a copy was included in the closing book sent to Pluhar. (BR. 1992 Tr. at 130-31). There is no evidence that Stoecker ever saw the letter. No opinion letter was issued to Chandler or Stoecker in connection with the transaction. (*Id.* at 136).[3]

Chandler registered the aircraft with the F.A.A. at an address in Oak Forest, Illinois, but never registered the aircraft with the Illinois Department of Transportation, Division of Aeronautics, as Illinois law required. *See* Ill. Rev. Stat. ch. 15½, ¶ 22.42 (1989). No certificate of registration could have been issued without proof either that Illinois use tax had been paid or that no tax was due.

[2] The Trustee asserts that Chandler purchased the aircraft in September 1988. (Pet. at 3). The Department has disputed this assertion, contending that for purposes of Illinois law the sale took place in June 1988 when Chandler put down the initial $2.45 million, signed the Agreement, and took possession of the aircraft. The court of appeals did not address this issue in its opinion, and the issue is not relevant to the question presented here.

[3] The statement in the petition that "Chandler obtained" the opinion letter (Pet. at 3) is incorrect. NEMLC obtained the letter, not Chandler. (B.R. 1992 Tr., Trustee Ex. 3).

3. The Illinois Use Tax

The Illinois "sales tax" scheme consists of two taxes: a retailer's occupation tax, Ill. Rev. Stat. ch. 120, ¶¶ 440-53 (1989), and a use tax, Ill. Rev. Stat. ch. 120, ¶¶ 439.1-.22 (1989). The occupation tax is a tax "upon persons engaged in the business of selling personal property" in Illinois. Ill. Rev. Stat. ch. 120, ¶ 441 (1989). The use tax is a complementary tax "upon the privilege of using in this State tangible personal property," regardless of whether the property is purchased in Illinois. Ill. Rev. Stat. ch. 120, ¶ 439.3 (1989).

Unlike the occupation tax, the use tax is imposed on the purchaser of the property. Retailers in Illinois and foreign retailers with an adequate nexus to Illinois are charged with collecting the tax and remitting it to the Illinois Department of Revenue. Ill. Rev. Stat. ch. 120, ¶ 439.3 (1989). However, any tax "not paid to a retailer . . . shall be paid to the Department directly by any person using such property within this State." *Id.* Purchasers from a retailer who does not pay the tax must file a return with the Department and pay the tax themselves. Ill. Rev. Stat. ch. 120, ¶ 439.10 (1989).

If no return is filed, the Department determines the tax due and issues a Notice of Tax Liability ("NTL") to the taxpayer. Ill. Rev. Stat. ch. 120, ¶ 444 (1989). The taxpayer may then file a protest and request a hearing. *Id.* If no protest is filed, the NTL becomes a final assessment. *Id.* Decisions of the Department, including final assessments, are subject to administrative review in the Illinois courts. Ill. Rev. Stat. ch. 120, ¶¶ 444, 451 (1989).

When a corporation fails to pay either the use or occupation tax it owes, responsible corporate officers and

employees may be held liable for a penalty equal to the unpaid tax:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed . . . and who wilfully fails to file such return or make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon . . . .

Ill. Rev. Stat. ch. 120, ¶ 452½ (1989). When the Department determines that a penalty should be imposed, the Department issues a notice of penalty liability ("NPL") to the officer or employee. *Id.* As with an NTL, the officer or employee can seek an administrative hearing and administrative review in the Illinois courts. *Id.*

Under Illinois law, the Department's decision to issue an NPL is deemed "prima facie correct" and "prima facie evidence of a penalty due under this Section." *Id.* Once the Department has issued an NPL to a corporate officer, the officer has the ultimate burden of proving that he is not liable for the penalty. *Branson v. Department of Revenue,* 168 Ill. 2d 247, 659 N.E.2d 961 (1995).

4. The Department of Revenue's Claim

Chandler filed no use tax return with the Department of Revenue and paid no use tax on its purchase of the aircraft. Chandler never filed tax returns of any kind

with the Department and was not registered with the Department in any capacity. The Department did not know about Chandler or the aircraft it purchased.

In early 1989, the Department was notified of Stoecker's bankruptcy. In accordance with its standard practice, the Department's bankruptcy unit researched Stoecker, uncovered several corporations associated with Stoecker that had tax liabilities, and filed claims in the bankruptcy against Stoecker as the responsible officer of the corporations. Because the Department's computer system displays only corporations that are registered taxpayers, the bankruptcy unit did not know about Chandler and did not link Chandler to Stoecker's bankruptcy.

In early 1990, a Department auditor in a different unit was reviewing F.A.A. title transfer documents for unreported aircraft purchases when he happened on Chandler's purchase of the aircraft. The Department began auditing the purchase. The auditor sent several letters to Chandler that went unanswered and also spoke to a salesman at JPA. Despite these efforts, the auditor never discovered Stoecker's connection to the corporation. In June 1990, the auditor sent a letter to Chandler proposing an audit liability for unpaid use tax. That letter, too, went unanswered. In late July 1990, the auditor obtained documents suggesting that Stoecker was an officer of Chandler, but, unaware of the bankruptcy, the auditor merely noted this in his records.

In September 1990, the Department formally issued an NTL to Chandler for the unpaid use tax on the aircraft. Chandler filed no protest, and the assessment became final by operation of law. There is no evidence that

Chandler sought administrative review of the assessment in the Illinois courts.

After the NTL was issued, the Department's collections division tried to collect the tax from Chandler. The collector initially sought to contact Chandler but determined that Chandler was out of business. He then made repeated efforts to contact Stoecker and Pluhar both by mail and in person, including sending a notice of intent to issue an NPL. Neither Stoecker nor Pluhar responded.

In June 1991, the Department's NPL unit formally issued an NPL to Stoecker assessing a penalty equal to the unpaid use tax. The NPL was sent certified mail but was returned unclaimed. No protest was filed, and the penalty assessment became final by operation of law. There is no evidence that Stoecker sought administrative review of the penalty assessment in the Illinois courts.

In September 1991, the Department sent Stoecker a demand for the assessed penalty. In response, counsel for Stoecker called the NPL unit and questioned Chandler's underlying tax liability. He later sent the NPL unit several letters enclosing documents about the sale. Neither in his initial telephone call nor in the two subsequent letters did Stoecker's counsel disclose that Stoecker was in bankruptcy.

In January 1992, Stoecker's counsel telephoned the Department's NPL unit again, asking what the Department intended to do. During this call, he revealed for the first time that Stoecker was in bankruptcy. The NPL unit immediately notified the bankruptcy unit, and on January 21, 1992, the Department filed a proof of claim in Stoecker's bankruptcy later amended to $911,769:

$868,351 in unpaid use tax and $43,418 in pre-petition interest.

5. Proceedings Below

As the court of appeals aptly observed, this case has "a complicated procedural history." (Pet. App. A-1). Most of that history is irrelevant to the question presented, as are the portions of the opinions addressing questions the Trustee has not raised.

In 1996, the bankruptcy court disallowed the Department's claim. In that court's view, the evidence did not prove Stoecker liable as a responsible officer who willfully failed to pay the tax. (Pet. App. C-45-74). The court acknowledged that the NPL was *prima facie* evidence of liability. (*Id.* at C-46, C-73). Nevertheless, the court said, once the Trustee presented evidence to rebut the presumption the NPL raised, the burden of proof shifted back to the Department, which had the "ultimate burden of proof." (*Id.* at C-73). The court appeared to rely on Bankruptcy Rule 3001(f) for this burden-shifting scheme. (*See id.* at C-5, C-73).

The district court affirmed the disallowance of the claim. Like the bankruptcy court, the district court relied on Bankruptcy Rule 3001(f) to place the ultimate burden of proof on the Department. (Pet. App. B-7). On this point, the court chose to follow *In re MacFarlane,* 83 F.3d 1041 (9th Cir. 1996), *cert. denied sub nom. California Franchise Tax Bd. v. MacFarlane,* 520 U.S. 1115 (1997), holding that the Department should not be able to benefit from a burden of proof that "arises outside of bankruptcy law." (*Id.* at B-9). The court agreed with the bankruptcy court that the burden had shifted back to the

Department and that the Department, relying primarily on the NPL, had not met its burden. (*Id.* at B-9-12).

The court of appeals reversed. In an opinion written by Chief Judge Posner, the court rejected the notion—advanced in *MacFarlane* and adopted by the district court—that bankruptcy is a kind of "equity free-for-all," one in which judges can curtail or expand entitlements based on "their personal notions of fairness." (Pet. App. A-9-10). Instead, the court said, bankruptcy courts have no authority to "cut down the entitlements that creditors seek to enforce in bankruptcy except as provided by the Bankruptcy Code itself." (*Id.* at A-9) (citation omitted). Burdens of proof are themselves entitlements (in part because they are "substantive" for purposes of the *Erie* doctrine), and the court found no indication in the Code "that [Congress] meant to shift the burden of proof from taxpayer to tax collector." (*Id.* at A-10-11). The Trustee's position, the court added, "would create a new incentive to declare bankruptcy. We have enough bankruptcies." (*Id.* at A-11).

The court accordingly found that the Trustee, not the Department, had the burden of proof, and that the Trustee had failed to meet it. The Trustee produced no evidence about Chandler's operations or Stoecker's role in filing tax returns or paying taxes that might have shown Stoecker was not a responsible officer. (*Id.* at A-7). And while Chandler had a copy of an opinion letter stating that no tax was due, there was no evidence that Stoecker himself ever saw the letter and no evidence that his failure to pay the use tax was not willful. (*Id.* at A-8). The court therefore concluded that the Department had a valid claim. (*Id.* at A-12).

REASONS FOR DENYING THE PETITION

The Trustee's petition should be denied for three reasons. First, the conflict in the circuits does not merit this Court's attention. The conflict is neither as widespread nor as serious as the Trustee makes out. Only four circuits have squarely confronted the question raised, and of those only two have addressed the question carefully and methodically. The two that have done so—the Fourth Circuit in *In re Landbank Equity Corp.*, 973 F.2d 265 (4th Cir. 1992), and the Seventh Circuit here—reached the same result for the same reasons. The decisions of the other two circuits are perfunctory and inconsistently reasoned. Without a clear rationale on the other side of the question presented, it is simply too soon for this Court to consider it.

Second, the question is not as significant as the Trustee and *amici* states would have it appear. The practical effect on federal and state tax collection is minimal. Where the ultimate burden of proof rests makes a difference primarily in audit cases like this one where the taxing body has almost no evidence available to it. Those cases are rare. The effect on federal tax collection, moreover, became even less significant after the Internal Revenue Service Restructuring and Reform Act of 1998. With certain exceptions, that Act shifted the burden of proof in "any court proceeding" to the I.R.S. 26 U.S.C. § 7491(a). The question presented does not deserve review.

Third, as the *amici* states argue, the court of appeals correctly decided the question. Nothing in the Bankruptcy Code or Rules alters the burden of proof that applies to tax claims under substantive tax law. The Trustee points to nothing, relying on "federal interests"

he says support a uniform burden of proof. (Pet. at 9). The only "interest" the Trustee identifies, however, is a policy of "equal treatment of creditors." (Pet. at 10). Assuming there is such an interest, in the allowance of claims all creditors are indeed treated equally: except where Congress has said otherwise, they retain the same substantive rights they held outside of bankruptcy. The Trustee is seeking better treatment for non-tax creditors, not equal treatment, and in doing so he is asking this Court to alter the rights of taxing bodies and change taxing schemes that Congress meant to leave unchanged.

The petition in this case raises a question that this Court declined to address only two years ago. *See In re MacFarlane*, 83 F.3d 1041 (9th Cir. 1996), *cert. denied sub nom. California Franchise Tax Bd. v. MacFarlane*, 520 U.S. 1115 (1997). The reasons to address it are even less "compelling" now than they were then. Sup. Ct. R. 10. The petition should be denied.[4]

I.

THE CONFLICT IN THE CIRCUITS DOES NOT WARRANT THIS COURT'S REVIEW.

Although the circuits are split on the burden of proof question, that split does not require attention now. The Trustee asserts that no less than eight circuits have

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[4] It is true, as the *amici* states observe, that the Solicitor General filed an *amicus* brief in *MacFarlane* stating that the Ninth Circuit lacked jurisdiction, and that "[p]erhaps" in denying certiorari this Court agreed. (St. Br. at 4-5). On the other hand, the denial may well have reflected this Court's views on the importance of the question, especially when only three circuits had considered it.

decided the question. (Pet. at 6). Five of the circuits, he says, have placed the burden in the bankruptcy court on taxing authorities, while a minority of three have done the opposite. The Trustee claims that this circuit conflict makes the question one of "widespread importance." (*Id.* 6). The *amici* states appear to agree. (St. Br. at 3, 7, 12).

The conflict is not nearly what the Trustee and *amici* states claim. In fact, only four circuits, including the Seventh Circuit here, have ever confronted the question presented. *See In re MacFarlane,* 83 F.3d 801; *Landbank,* 973 F.2d 265; *In re Fidelity Holding Co.,* 837 F.2d 696 (5th Cir. 1988). Decisions from other circuits do not discuss or resolve the question but simply assume a particular burden of proof. *See, e.g., In re Brown,* 82 F.3d 801, 805 (8th Cir. 1996); *Bronson v. United States,* 46 F.3d 1573, 1581-82 (Fed. Cir. 1995); *In re Fullmer,* 962 F.2d 1463, 1466 (10th Cir. 1992); *Resyn Corp. v. United States,* 851 F.2d 660, 663 (3rd Cir. 1988). The conflict that the other parties identify exists mostly in *dicta*.

The Seventh Circuit itself illustrates the odd tendency for *dicta* on this issue to be taken as something more. Like so many circuits, the Seventh Circuit decided an earlier case, *United States v. Charlton,* 2 F.3d 237 (7th Cir. 1993), in which the court simply assumed a certain burden of proof. Lower courts proceeded to cite *Charlton* as what the Seventh Circuit had "held." *See, e.g., Thinking Machines Corp. v. New Mexico Taxation & Revenue Dep't,* 211 B.R. 426, 429 (D. Mass. 1997). In *In re Carlson,* 126 F.3d 915, 921 (7th Cir. 1997), *cert. denied,* 523 U.S. 1060 (1998), however, the Seventh Circuit commented that it had not in fact resolved the question. The court did not resolve it until this case. Most of the decisions the Trustee cites no more represent what those

circuits "hold" than *Charlton* represented what the Seventh Circuit held. The circuit split is, to a large extent, more apparent than real.

As for the circuits that have actually decided the burden of proof question, they do not pose the kind of conflict that merits this Court's attention. The Seventh and Fourth Circuit decisions considered the question in detail and analyzed it carefully. Those decisions are in agreement. The Fifth and Ninth Circuit decisions, on the other hand, did neither and did not even agree with each other. It is not clear that the Fifth Circuit would reach the same result today.

In *Fidelity Holding Co.*, the first case to consider the question, the Fifth Circuit based its decision entirely on former Bankruptcy Rule 301(b). That rule, the court said, did not "differentiate between government and private claimants when proofs of claim are filed" and so created an "exception" to the general rule placing the burden of proof on the taxpayer. 837 F.2d at 698. The court not only misconstrued the rule (wrongly believing it concerned burdens of proof), the court cited nothing in the Code to support its conclusion and seemed to have the Rules and the Code confused. *Id.* Five years later, in *In re Placid Oil, Co.,* 988 F.2d 554, 557 (5th Cir. 1993), the Fifth Circuit reached the same result in a single paragraph, relying solely on *Fidelity*. This time, the court did not cite either the Code or the Rules, nor did it mention the Fourth Circuit's decision reaching the opposite result. *Id.*; *see also* 15 *Collier on Bankruptcy* ¶ TX5.04[6] at TX5-44 n.56 (Lawrence P. King, ed., rev. 15th ed. 1999) (criticizing *Placid Oil*).

In *MacFarlane*, the Ninth Circuit also cited and relied on *Fidelity*, finding its "logic . . . compelling." 83 F.3d at 1045. In the very next sentence, however, the court seemed to disagree with *Fidelity*'s "logic," conceding that in fact "[t]he bankruptcy code is silent on the allocation of the ultimate burden of proof in this case." *Id.* Unlike the Fifth Circuit, the court then "turn[ed] to policy considerations." *Id.* Balancing "the equities" between California and the other creditors, and noting that tax claims already receive priority in distribution, the court concluded that a taxing authority should not receive the "double benefit" of a burden of proof with "its origins outside of bankruptcy law." *Id.* (internal quotations omitted).

In contrast, the Fourth Circuit in *Landbank* and the Seventh Circuit in this case addressed the question of the appropriate burden of proof in detail, employing the same cogent analysis. *See Landbank,* 973 F.2d at 268-72; (Pet. App. A-8-11). Both courts agreed that the burden of proof under tax law generally falls on the taxpayer and that burdens of proof are substantive law. *Landbank,* 973 F.2d at 269-70; (Pet. App. A-10). Both agreed that although Congress can alter substantive rights in the Code, it has done nothing to alter the burden of proof for tax claimants. *Landbank,* 973 F.2d at 269-70; (Pet. App. A-11). And both agreed that equitable considerations alone do not permit bankruptcy courts to undo the substantive rights of taxing bodies in bankruptcy. *Landbank,* 973 F.2d at 271-72; (Pet. App. A-9-10).

Decisions of the courts of appeals aside, the Trustee claims that this case should be reviewed because of the "continuing conflicting decisions rendered by" district

courts and bankruptcy courts. (Pet. at 6). He mentions as well the "sharp clash of viewpoints" between the Seventh Circuit and the district and bankruptcy courts, something "likely to generate additional controversy." (Pet. at 6).[5]

Conflicting district court and bankruptcy court decisions are not a ground for granting certiorari and are relevant, if at all, only to the extent they show confusion over the issue. Robert L. Stern, Eugene Gressman, Stephen M. Shapiro & Kenneth S. Geller, *Supreme Court Practice* § 4.8 at 179-180 (7th ed. 1993). There is no confusion here. The lower courts the Trustee mentions, for example, simply noted the dearth of authority from their courts of appeals and then followed other circuits or lower court decisions in their own circuits. *See Barrows v. I.R.S.,* 231 B.R. 446, 451 (D.N.H. 1998); *In re Forte,* 234 B.R. 607, 617-18 (Bankr. E.D.N.Y. 1999). Whatever confusion there is in the district and bankruptcy courts exists only over whether certain circuits have actually decided the burden of proof question. *See, e.g., Barrows,* 231 B.R. at 450 (erroneously citing *Charlton* and other decisions as having reached the question).

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[5] As another sign of the "controversy," the Trustee notes that the Tax Advisory Committee of the National Bankruptcy Review Commission endorsed proposals under which (1) the burden of proof from tax law would apply in the bankruptcy courts, but (2) the burden could be adjusted when the objector was not the debtor. (Pet. at 7 n.2). That was the Committee's view. The Commission, on the other hand, recommended only that Congress amend the Code "to clarify" that the tax law burden of proof be "equally applicable in bankruptcy court proceedings to determine tax liabilities under 11 U.S.C. §§ 502 and 505." *Final Report of the National Bankruptcy Review Commission* at § 3.2.5 (Oct. 20, 1997) (reprinted in vol. G *Collier on Bankruptcy* app. pt. 44 at 44-806 (rev. 15th ed. 1999)).

The "sharp clash of viewpoints" in the Seventh Circuit, meanwhile, is also irrelevant. This Court "will not grant certiorari to review a decision of a federal court of appeals merely because it is in direct conflict on a point of federal law with a decision rendered by a district court, whether in the same circuit or in another circuit." Robert L. Stern, et al., *supra,* § 4.8 at 178. Any confusion among lower courts in the Seventh Circuit was resolved when the court of appeals issued its decision in this case.

The split in the circuits, then, neither requires nor deserves this Court's review. Only four courts of appeals have decided the question here. Of those, the Seventh and Fourth Circuits employed the same thorough analysis to reach the same result. The Fifth and Ninth Circuits, by contrast, issued short, superficial, and inconsistently reasoned decisions. Although there is a split, the lines are not yet clearly drawn because the positions of the circuits on one side of the split are neither carefully thought out nor sharply defined. With time, the courts of appeals will likely resolve the question. It would be premature for the Court to consider it now.

II.

THE QUESTION PRESENTED IS NOT IMPORTANT ENOUGH FOR THIS COURT TO ADDRESS.

Just as there is a conflict in the circuits too insignificant to be worth resolving now, the question presented is not important enough to warrant this Court's attention. The Trustee asserts without any basis that the question "arises in every case" where an objection is filed to a tax claim. (Pet. at 7). Because "the overwhelming majority" of bankruptcy cases involve tax claims, he says, the question is vitally important to bankruptcy administration. (*Id.*).

The Trustee greatly overstates matters. First, not every bankruptcy case involves a claim for unpaid taxes. Many debtors owe no taxes. Even where taxes are owed, many bankruptcies are "no asset" cases in which the filing of claims is actively discouraged and so few claims are filed. Illinois itself files claims only in a fraction of bankruptcies. In the twelve months ending September 30, 1998, there were 65,337 bankruptcy cases commenced in Illinois bankruptcy courts. *See* Administrative Office of U.S. Courts, *Judicial Business of the United States Courts: 1998 Report of the Director* at 278 (Table F) (1998). During the same period, the Department filed 2,721 bankruptcy claims (a figure, incidentally, that includes claims in all bankruptcy courts, not just those in Illinois). In other words, the Department filed claims in fewer than 4% of Illinois bankruptcies. Those claims totaled only $12,428,371, or an average of $4,567.57. The "overwhelming majority" of bankruptcies (Pet. at 7) do not involve tax claims.[6]

Second, not every tax claim in bankruptcy hinges on which party bears the burden of proof. In some cases, as the Trustee seems to concede, no objections to tax claims are filed. When they are, in most cases liability is admit-

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[6] The *amici* states, more experienced tax collectors than the Trustee, do not assert that the question presented affects the "overwhelming majority" of bankruptcies. They note only that burden of proof problems arise in audit cases where there is little or no evidence. (St. Br. at 14). True enough. As the Department points out below, however, those cases are unusual.

ted; the sole question is whether the taxing body's proof of claim accurately reflects the amount of the liability and any penalties or interest. Tax claims in bankruptcy will turn on who bears the burden of proof primarily (1) in audit cases, i.e., cases where liability is not admitted, (2) where an objection is filed, and (3) where there is little or no evidence available to the taxing authority making the claim. Those cases are rare. In the Department's experience, fewer than 5% of the cases in which claims are filed (itself a small percentage of total bankruptcies) fit this description. The burden of proof question does not prove critical in "every case" (Pet. at 7) where a tax claim prompts an objection.

This case is one of the rare ones. Not only is it a bankruptcy involving a tax claim, but it is an audit case where the tax claim drew an objection asserting no liability, where there was virtually no evidence on the liability question, and where there was a lot of money at stake. Moreover, the debtor was a criminal defendant who invoked his Fifth Amendment privilege at his deposition and refused to cooperate with anyone. Except in cases like this, the question of who bears the burden of proof—the taxing authority or the taxpayer—has no serious effect on federal and state tax collection.

It is also worth noting that this question has even fewer consequences for federal tax collection now than it used to. In the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, Congress amended the Internal Revenue Code, changing substantive federal tax law to place the burden of proof on the I.R.S. *See* 26 U.S.C. § 7491(a). The amendment applies in "any court proceeding," *id.*, and so applies to federal tax

claims in the bankruptcy courts, 15 *Collier on Bankruptcy*, *supra*, ¶ TX5.03[5] at TX5-26-27. Although section 7491 contains specific prerequisites that must be met before the burden of proof will shift to the I.R.S., the enactment of section 7491 still diminishes the importance of the question in this case for the United States.

The question presented here is stimulating and is undeniably of some interest to taxing authorities.[7] However, this Court "does not sit to satisfy a scholarly interest," *Rice v. Sioux City Mem. Park Cemetery*, 349 U.S. 70, 74 (1955), even when "serious legal questions" may be involved, *English v. Cunningham*, 361 U.S. 905, 907 (1959) (Frankfurter, J.) (mem. on denial of cert.). The question here arises infrequently. The practical impact of its resolution on tax collection and on bankruptcy administration will not be what the Trustee and *amici* states suggest. The question does not deserve review.

III.

THE DECISION OF THE COURT OF APPEALS WAS CORRECT.

Finally, the petition should be denied because the court of appeals correctly decided the burden of proof question. Review of its decision is consequently unnecessary. The

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[7] But not as important to the states, apparently, as it once was. Twenty-four states submitted an *amicus* brief supporting the petition in *MacFarlane*. (St. Br. at 4). Nine have done so here. Of the nine, only four are from the Ninth Circuit and none are from the Fifth, although states from those circuits, at least, might have been expected to have some interest in the issue.

Department agrees with the *amici* states' argument on the merits (*see* St. Br. at 5-6, 7-14, 15-17) and incorporates that argument as its argument here. The Department adds only the following two points.

First, as the court of appeals held, the question of whether the burden of proof for tax claims changes in bankruptcy is a question of what the Bankruptcy Code provides. (*See* Pet. App. A-11). That is because Congress "has not hesitated to make [its] intentions clear" when it believed the bankruptcy system necessitated some alteration in the rights that parties hold under substantive law. *Landbank*, 973 F.2d at 270; *see also Butner v. United States*, 440 U.S. 48, 54 (1979). Even the Ninth Circuit in *MacFarlane* recognized what the court of appeals here correctly found (Pet. App. A-11): nothing in the Code or the Bankruptcy Rules purports to shift the burden of proof in tax cases away from taxpayers and onto the government. *MacFarlane*, 83 F.3d at 1045; *see also Landbank*, 973 F.2d at 270-71; 15 *Collier on Bankruptcy*, *supra*, ¶ TX5.03[5] at TX5-24.

The Trustee makes no effort in his petition to locate in either the Code or Rules some source for the burden of proof he would assign to taxing authorities. In fact, the Code barely rates a mention. Instead, the Trustee depends on what he calls "the federal interests supporting a uniform allocation of the burden of proof in bankruptcy cases." (Pet. at 8). Tax claims, he says, already receive favorable treatment, and taxing authorities therefore end up with a "decided advantage." (Pet. at 8).

Although the Trustee never actually uses the word "unfair," this is little different from the Ninth Circuit's

reasoning in *MacFarlane*. Unable to find anything in the Code supporting his position, the Trustee resorts to what the court of appeals here rightly called an "equity free-for-all." (Pet. App. A-10). Vague notions of fairness not grounded in the Code are no basis for disturbing the substantive rights of taxing authorities. *See United States v. Noland*, 517 U.S. 535, 540-41 (1996).

Second, the Trustee is mistaken even in claiming that policy, if not law, is on his side. He asserts that the rationale for placing the burden on the taxpayer makes no sense when trustees and creditors object to tax claims because, unlike the debtor, those parties are in no better position than the government: they have no more information about the debtor's affairs than the government does. (Pet. at 8).

The National Bankruptcy Review Commission, though, suggested otherwise. The Commission observed that the "government's position as a tax creditor in a claims contest is different from other creditors in a normal debtor-creditor relationship" because the government is *less* likely to have information about the debtor and his dealings than other creditors. *Final Report*, *supra*, at § 3.2.5 (reprinted in vol. G *Collier on Bankruptcy* app. pt. 44 at 44-811). And even assuming the Trustee is right, maintaining the same burden of proof in bankruptcy leaves other creditors no worse off than when the government brings its claim outside of bankruptcy, in state or federal court. The knowledge creditors have of a taxpayer's affairs does not magically disappear when the taxpayer files bankruptcy.

If anything, in fact, the trustee and other creditors are *better* off when the government makes tax claims in bankruptcy. A trustee in bankruptcy, after all, has the right to obtain relevant books and records from the debtor for the benefit of the remaining creditors. 15 *Collier on Bankruptcy*, *supra*, ¶ TX5.03[5] at TX5-25 n. 57 (noting that arguments of the kind the Trustee makes to justify shifting the burden of proof overlook this right). More important, creditors in bankruptcy are given written notice of tax claims and have standing to object to them. Creditors have no such rights when the government sues for taxes in state courts or other federal courts.

The Trustee's complaints about relative access to information mask what is really his larger policy argument: that placing the burden of proof on the party objecting to a tax claim defeats some federal interest in "the equal treatment of creditors." (Pet. at 10).

This argument goes nowhere. Where the allowance of claims is concerned, all creditors—private creditors and the government—*are* treated equally under the Code. As the court of appeals here correctly observed, except where Congress has expressly changed substantive rights all parties come into the bankruptcy court with the same rights and entitlements they had outside of bankruptcy. (Pet. App. A-9); *see also Butner*, 440 U.S. at 57 ("basic federal rule" in bankruptcy when state property rights are at issue "is that state law governs"). All creditors are treated identically because the position they held is neither improved nor worsened and the strength of their claim is neither increased nor decreased. In urging the

adoption of a different burden of proof for tax claims in bankruptcy, one less favorable to the government, the Trustee is not advocating "equal treatment" for non-tax creditors. He wants better treatment.

Where the distribution of claims is concerned, on the other hand, it is true that the government enjoys a favored status in bankruptcy. When it comes to parceling out the assets of the estate, tax claims have long been preferred under bankruptcy law, *see United States v. Reorganized CF & I Fabricators of Utah*, 518 U.S. 213, 330 & n.4 (1996), and with good reason. Unlike other creditors, a tax creditor is a nonconsensual creditor, and its losses are passed on to the public through higher taxes. *Thinking Machines*, 211 B.R. at 431 n.8. The "egalitarian appeal" of the Trustee's argument—one that assumes an overall policy under the Code of equal treatment of creditors—"overlooks the frequent disparate treatment of the government as tax-creditor found in the Bankruptcy Code regarding such matters as the priority and dischargeability of claims." 15 *Collier on Bankruptcy*, *supra*, ¶ TX5.03[5] at TX5-25. In the distribution of claims, some creditors are indeed more equal than others.

Tax claims are favored in distribution, though, not because of some unexpressed bankruptcy "policy," and not as the result of some court's conception of the "federal interests" underlying bankruptcy administration. They are favored because *Congress* decided to favor them in the Bankruptcy Code. Congress expressly made tax claims priority claims, 11 U.S.C. § 507(a)(8), and expressly rendered them non-dischargeable, 11 U.S.C. § 523(a)(1). (Pet. App. A-11).

Had it wanted it to, of course, Congress could have altered the substantive rights of taxing authorities in the allowance of claims as well as in their distribution. Congress could have eliminated the favorable burden of proof under tax law, replacing it with something else. But the question in this case is whether Congress chose to do so in the Code, not whether bankruptcy courts can do so as a matter of rough justice. *See Noland*, 517 U.S. at 540-41. The court of appeals here rightly found that the answer to that question is no. (Pet. App. A-11); *see also Landbank*, 973 F.2d at 270. And because "state law governs" property rights in bankruptcy unless Congress has seen fit to change those rights, *Butner*, 440 U.S. at 57, the burden of proof under substantive tax law continues to apply when tax claims are brought in the bankruptcy courts.[8]

The decision of the court of appeals on the question presented was correct, both as a matter of law and as a matter of policy. The Trustee's petition should therefore be denied.

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[8] To the extent there is any doubt about the intent of Congress, Congress may clear up the doubt even before the courts of appeals do. As the Department noted earlier, the National Bankruptcy Review Commission has recommended that Congress "clarify" that the burden of proof is unchanged and falls on the taxpayer when tax claims are brought in the bankruptcy court. *See Final Report*, *supra*, at § 3.2.5 (reprinted in vol. G *Collier on Bankruptcy* app. pt. 44 at 44-806).

CONCLUSION

The petition for a writ of certiorari should be denied.

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IN THE
Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee
for the Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS,
DEPARTMENT OF REVENUE,

Respondent.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR PETITIONER

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QUESTION PRESENTED

Should tax claims in bankruptcy cases be given the advantage of placing the burden of persuasion on an objecting trustee, in contrast to the rule applicable to the claims of other creditors?

STATEMENT PURSUANT TO RULE 24.1(B)

The caption of the case in this Court lists all parties to the proceeding in the court of appeals.

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No. 99-387

IN THE

Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee
for the Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS,
DEPARTMENT OF REVENUE,

Respondent.

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT**

BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-13)[1] is reported at 179 F.3d 546. The memorandum opinion and order of the district court (Pet. App. B1-21) is unreported. The memorandum opinion of the bankruptcy court (Pet. App. C1-82) is reported at 202 B.R. 429. Earlier related opinions of the district court (Pet. App. D1-30) and the bankruptcy court (Pet. App.E1-40) are reported at 179 B.R. 532 and 151 B.R. 689, respectively.

[1] "Pet. App." refers to the Appendices to the Petition for a Writ of Certiorari.

JURISDICTION

The judgment of the court of appeals was entered on June 2, 1999. The petition for a writ of certiorari was filed on August 31, 1999. The petition was granted on January 7, 2000. The jurisdiction of this Court arises under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND RULES INVOLVED

United States Code, Title 11:

§ 501. Filing of proofs of claims or interests.

(a) A creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest.

§ 502. Allowance of claims or interests.

(a) A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.

Federal Rules of Bankruptcy Procedure:

Rule 3001. Proof of Claim.

(f) Evidentiary Effect. A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim.

STATEMENT OF THE CASE

Petitioner Thomas E. Raleigh is the Chapter 7 trustee (the "Trustee") for the bankruptcy estate of William J. Stoecker ("Stoecker"). This case involves the Trustee's objection to the allowance of a proof of claim filed by the State of Illinois, Department of Revenue (the "Department")

arising from the failure of a corporation of which Stoecker was an officer to pay use taxes on the purchase of an airplane.

Stoecker was the president and a director of Chandler Enterprises, Inc. ("Chandler"), an Illinois corporation located in Oak Forest, Illinois. (Pet. App. B2 and C15.) In June, 1988, Chandler entered into a "Lease Purchase Agreement" with Prewitt Leasing, Inc. ("Prewitt Leasing"), a company located in Texas, for a Falcon 50 airplane. (Pet. App. C15.) Chandler subsequently exercised its purchase option and acquired title to the airplane on September 30, 1988.[2] (Pet. App. E4.) Chandler then leased the airplane to Grabill Corporation, another Illinois corporation of which Stoecker was president and sole shareholder. (Pet. App. D3.)

Chandler's purchase of the airplane was financed by NEMLC Leasing Corporation ("NEMLC") of Boston, Massachusetts. (Pet. App. C16.) NEMLC requested that Chandler provide an opinion of counsel relating to the tax ramifications of Chandler's purchase of the airplane. John Anderson ("Anderson"), an attorney with the Chicago law firm of Lord Bissell & Brook who acted as counsel for both Chandler and Grabill, issued an opinion letter dated September 30, 1988 in which he opined that Chandler's purchase of the airplane did not give rise to sales or use tax liability under Illinois law because it constituted an "occasional sale" exempt from such tax. (Pet. App. C16-17.) Anderson's conclusion was supported by a "Certificate Re Occasional Seller Exemption from Illinois Sales and Use

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[2] Title documents for the airplane indicate that, on May 30, 1988, Opex Aviation, Inc. ("Opex") had acquired title from Bezwada Investments, Inc., an Australian company. (Pet. App. C16.) On June 1, 1988, Opex transferred title to the airplane to Jack Prewitt & Associates ("Jack Prewitt"). (Pet. App. E4.) The transfer of title from Opex to Jack Prewitt on June 1, 1988 was inadvertent in that the parties had intended to transfer title from Opex to Prewitt Leasing. Thus, on September 30, 1988, Jack Prewitt transferred title to the airplane to Prewitt Leasing to enable Prewitt Leasing to transfer title to Chandler that same day. (Pet. App. C16, 40.)

Tax" (the "Certificate") from Prewitt Leasing dated September 30, 1988. (Pet. App. C17.) In the Certificate, Prewitt Leasing represented that it was in the business of leasing aircraft and, prior to the sale to Chandler, had sold only one other aircraft. (Pet. App. C41.) Chandler did not seek a private letter ruling from the Department regarding the tax consequences of its purchase (Pet. App. C17), and neither Chandler nor Prewitt Leasing paid any Illinois sales or use taxes on Chandler's purchase of the airplane. (Pet. App. C16.)

Although incorporated in Illinois, Chandler did not register with the Department and never filed state tax returns. Likewise, although the airplane was based in Illinois, Chandler did not register the airplane with the Illinois Department of Transportation. (Pet. App. C18.) Chandler was involuntarily dissolved by the Illinois Secretary of State on June 1, 1990. (Pet. App. D3.)

On February 21, 1989, an involuntary petition under Chapter 11 was filed against Stoecker. On March 20, 1989, Thomas E. Raleigh was appointed Chapter 11 trustee. The case was converted to Chapter 7 on February 26, 1990, and Raleigh became Chapter 7 trustee. (Pet. App. E2.)

While the case was still in Chapter 11, the Department filed three proofs of claim (and one amended claim) in the estate totaling $14,219.24. Those proofs of claim sought withholding taxes and Retailers' Occupation/Use Taxes allegedly owed by Stoecker as a responsible officer of two other corporations, The Cook's Cupboard and Eagle Line, Inc. No objections were filed to those claims, and they were deemed allowed under 11 U.S.C. § 502(a). (Pet. App. E3.) The Department did not file any claims relating to Chandler prior to conversion.

After conversion to Chapter 7, the bankruptcy court issued an order providing, *inter alia*, that all proofs of claim were to be filed within ninety days of the March 28, 1990 meeting of creditors under 11 U.S.C. § 341. (Pet. App. E2.)

The Department did not file a proof of claim relating to Chandler prior to the June 26, 1990 bar date. (Pet. App. E3.)

In March 1990, Mark Russell ("Russell"), an employee of the Department's audit division, received a commercially prepared report of various aircraft purchases. That report showed Chandler's purchase of the airplane in September, 1988. Based on the purchase price of the airplane, the Department determined that Chandler owed use taxes[3] totaling $836,000. After several letters to Chandler went unanswered, the Department issued a Notice of Tax Liability to Chandler in September 1990 for the unpaid use taxes. (Pet. App. C18-19.)

In June 1990, Russell learned through inquiries with the Illinois Secretary of State's office that Stoecker was an officer and director of Chandler and, thus, potentially liable for the use tax obligation as a "responsible officer" who "willfully" failed to pay the tax.[4] (Pet. App. C17-19.) After several unsuccessful attempts to contact Stoecker, the Department issued a Notice of Penalty Liability ("NPL") to Stoecker in June 1991 assessing a penalty against Stoecker equal to the amount of Chandler's unpaid use tax obligation. (Pet. App. C19.) Several months later, in January 1992, the Department's notice of penalty liability section learned that Stoecker was in bankruptcy, and the Department filed a proof

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[3] "Sales" taxes under Illinois law have two components. The Retailers' Occupation Tax Act imposes a tax on those engaged in the business of selling personal property at retail. Ill. Rev. Stat., ch. 120, ¶ 440 *et. seq.* (1989) (re-codified at 35 ILCS 120/1 *et seq.* (1992)). The Use Tax Act imposes a tax on Illinois residents who buy personal property from out-of-state sellers. Ill. Rev. Stat., ch. 120, ¶ 439.1 *et. seq.* (1989) (re-codified at 35 ILCS 105/1 *et seq.* (1992)).

[4] *See* Ill. Rev. Stat., ch. 120, ¶ 452 ½ (1989) (re-codified at 35 ILCS 120/13.5 (repealed 1994)). This provision of the Retailers' Occupation Tax Act was incorporated into the Use Tax Act pursuant to Ill. Rev. Stat., ch. 120, ¶ 439.12 (1989) (re-codified at 35 ILCS 105/12 (1992)). Effective January 1, 1994, 35 ILCS 120/13.5 was repealed, and "responsible officer liability" was re-codified at 35 ILCS 735/3-7 (1996).

of claim asserting a priority claim in the amount of approximately $1,476,000, later reduced by the Department to $917,000. (Pet. App. C20 and n.12.) The basis for the Department's priority claim was the NPL issued to Stoecker as a "responsible officer" who "willfully" failed to pay the use taxes allegedly owed by Chandler.

Pursuant to 11 U.S.C. § 502 and Rule 3007 of the Federal Rules of Bankruptcy Procedure, the Trustee filed an objection to the Department's proof of claim. (Pet. App. C22.) The Trustee argued, *inter alia*, that under Illinois law, Stoecker was not a "responsible officer" and did not "willfully" fail to file a return or remit the use tax owed by Chandler. Between 1992 and 1997, there were extensive proceedings in the bankruptcy and district courts -- including evidentiary hearings -- resulting in a number of published and unpublished opinions. (Pet. App. B, C, D, and E). The bankruptcy court ruled that under Federal Rule of Bankruptcy Procedure 3001(f), the Department's proof of claim was *prima facie* evidence of the validity and amount of that claim. The bankruptcy court determined that, if the Trustee successfully rebutted that *prima facie* evidence, the burden of persuasion remained with the Department – as with any other creditor in a bankruptcy proceeding – to prove its claim by a preponderance of the evidence. (Pet. App. C5.)

The bankruptcy court ultimately held, *inter alia*, that the Trustee successfully rebutted the *prima facie* validity of the Department's proof of claim and that the Department failed to satisfy its burden of persuasion to prove its claim by a preponderance of the evidence. (Pet. App. C73-74.) Accordingly, the bankruptcy court sustained the Trustee's objection. (Pet. App. C81.) The Department filed a timely notice of appeal to the district court. (Pet. App. B4.)

After subjecting the bankruptcy court's allocation of the burden of persuasion to *de novo* review, the district court concurred that the burden of persuasion rested with the Department. Because the Department had produced no evidence beyond the NPL itself and the records of the Illinois

Secretary of State listing Stoecker as an officer and director of Chandler, the district court held that the bankruptcy court's decision that the Department had failed to prove its claim by a preponderance of the evidence was not clearly erroneous and, therefore, affirmed. (Pet. App. B.) The Department filed a timely notice of appeal to the court of appeals for the seventh circuit. (Pet. App. A2.)

The court of appeals reversed on the ground that the burden of proof under non-bankruptcy law controlled in claim objection proceedings in bankruptcy court. The court of appeals determined that, "just as under the corresponding federal law of responsible-officer liability for unpaid taxes, 26 U.S.C. § 6672; ... Illinois shifts the burden of proof — both production and persuasion — to the officer once a Notice of Penalty Liability is issued...." (Pet. App. A7.) The court of appeals rejected the rulings of the lower courts and the argument of the Trustee that, in a claim objection proceeding in a bankruptcy case, the Department, as creditor, bears the burden of persuasion to prove its claim by a preponderance of the evidence. The court of appeals found "no indication" in the Bankruptcy Code that Congress intended that bankruptcy courts employ a burden of persuasion for tax claims that was different from that arising under state law. (Pet. App. A11.) Finding that the evidence offered by the Trustee — while perhaps sufficient to satisfy the burden of production — was not sufficient to sustain the Trustee's burden of persuasion, the court of appeals reversed the district court's decision and found that the Department had a valid claim. (Pet. App. A7, 12.)

SUMMARY OF THE ARGUMENT

The issue in this case is whether the State of Illinois, Department of Revenue, as creditor, or the bankruptcy trustee, as objecting party, should bear the burden of persuasion on the allowance of a tax claim in a bankruptcy proceeding when under state law, the burden of persuasion rests with the taxpayer to disprove liability for the tax. The Bankruptcy

Code of 1978, 11 U.S.C. § 101 *et seq.* (the "Bankruptcy Code" or the "Code"), is silent on the allocation of the burden of persuasion in claim objection proceedings. The Federal Rules of Bankruptcy Procedure, while addressing the initial burden of production, likewise do not address the burden of persuasion.

The court of appeals held that burdens of persuasion are part of a state's substantive law, and, because Congress had not specifically addressed burdens of persuasion in claim objection proceedings, state law burdens of persuasion govern. The court of appeals found that, outside of bankruptcy, Stoecker would have had the burden of persuasion under Illinois law to disprove his responsible officer liability, and thus the Trustee, rather than the Department, bore the burden of persuasion on the Trustee's objection to allowance of the Department's claim in the bankruptcy case. This conclusion ignores pre-Code practice and the legislative history of the Code, misapplies the Court's decision in *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), and depreciates the policy and equitable considerations supporting a uniform allocation to all creditors of the burden of persuasion in claim objection proceedings.

Since the passage of the Chandler Act in 1938, tax claims have been treated like any other claims in bankruptcy proceedings. The policies supporting imposition of the burden of persuasion on taxpayers in typical state or federal court litigation have little if any application in a bankruptcy proceeding where the fight is not between the taxing authority and the taxpayer, but between the taxing authority and all of the other creditors of the taxpayer as they vie for their fair share of a limited pool of assets. Having chosen to file a proof of claim in the bankruptcy proceeding, the Department should be governed by the same rules as any other creditor, including the burden of persuasion to prove its claim by a preponderance of the evidence.

ARGUMENT

I.

THE EVOLUTION OF THE TREATMENT OF TAX CLAIMS IN BANKRUPTCY PROCEEDINGS SUPPORTS IMPOSING THE BURDEN OF PERSUASION IN CLAIM OBJECTION PROCEEDINGS ON TAXING AUTHORITIES

The typical procedure in claim objection proceedings in bankruptcy is that the creditor bears the burden of persuasion to prove its claim. *In re Allegheny Int'l, Inc.*, 954 F.2d 167, 175 (3d Cir. 1992); *In re Harrison*, 987 F.2d 677, 680 (10th Cir. 1993). A properly filed proof of claim is *prima facie* evidence of the validity and the amount of the claim. Fed. R. Bankr. P. 3001(f). In the absence of an objection, the proof of claim is deemed allowed. 11 U.S.C. § 502(a). If an objection is lodged, the objector has the burden of production to introduce evidence rebutting the *prima facie* validity of the claim. *Allegheny*, 954 F.2d at 173. A mere denial of the claim does not rebut the presumption of validity, *In re Transamerican Natural Gas Corp.*, 978 F.2d 1409, 1416 (5th Cir. 1992), and if the objector's evidence is otherwise insufficient to rebut the evidence supporting the proof of claim, the claim will be allowed. If, on the other hand, the bankruptcy court finds that the objector has successfully rebutted the *prima facie* validity of the claim, the claimant must sustain the burden of persuasion to prove its claim. *In re Placid Oil Co.*, 988 F.2d 554, 557 (5th Cir. 1993). The bankruptcy court's factual findings are reviewed on a "clearly erroneous" basis. *Id.*

The Department argues that it does not bear the burden of persuasion in claim objection proceedings. The Department contends that bankruptcy courts are required to apply burdens of persuasion created under state substantive tax laws. Because, under Illinois substantive tax law, the

burden of persuasion to disprove tax liability is on the taxpayer, the Department contends that the burden of persuasion should be on the bankruptcy trustee to disprove the Department's tax claim.

An analysis of the evolution of the treatment of tax claims in bankruptcy proceedings indicates that taxing authorities should bear the same burden of persuasion as that borne by all other creditors in claim objection proceedings. The overwhelming majority of pre-Code decisions placed the burden of persuasion on taxing authorities, and there is nothing in the legislative history or the language of the Code itself to indicate that Congress intended to change that practice.

A.

Pre-Code Practice

The treatment of state and federal tax claims in bankruptcy proceedings has evolved since the passage of the Bankruptcy Act of 1898 (the "Bankruptcy Act" or the "Act"). Under the Bankruptcy Act as originally enacted, tax claims were not treated as claims against the estate, but rather as obligations of the debtor that had to be paid ahead of the debtor's traditional debts. *New Jersey v. Anderson*, 203 U.S. 483, 492 (1906). Tax claims were not required to be filed or proved under section 57 of the Bankruptcy Act, 11 U.S.C. § 93, and section 64 of the Bankruptcy Act, 11 U.S.C. § 104, required the bankruptcy trustee to seek out, determine, and pay all taxes legally due and owing. *Nicholas v. United States*, 384 U.S. 678, 682 n.10 (1966). The bankruptcy court could, however, establish a bar date for all claims, including tax claims, and tax claims not filed by that date were disallowed. *New York v. Irving Trust Co.*, 288 U.S. 329, 331 (1933).

The privileged status of tax claims began to erode in 1926 when Congress amended section 64 of the Bankruptcy Act to reduce tax claims to a priority status behind administrative claims and certain wage claims. 44 Stat. 662, 666-67 (1926) (codified as amended at 11 U.S.C. § 104).

Still, in the absence of a court-ordered bar date, there was no specific requirement for filing or proving tax claims.

The Chandler Act of 1938, 52 Stat. 840, significantly altered the treatment of tax claims in bankruptcy. For the first time, governmental claims, including tax claims, were required to be filed and proved:

> all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section.

52 Stat. 840, 867, (1938) (codified as amended at 11 U.S.C. § 93n). Tax claims were also classified as fourth-tier priority claims. 52 Stat. 840, 874 (codified as amended at 11 U.S.C. § 104a). Because of the difficulties that governmental entities often encountered in preparing and filing claims within the time allotted for other creditors, the Chandler Act amended section 57n of the Bankruptcy Act to enable governmental entities to request extensions of the filing deadline. *Id.*; S. Rep. No. 1916, 75th Cong., 3d Sess., at 5 (1938). Apart from the ability to request extensions of time to file claims, however, the legislative history of the Chandler Act indicates that Congress intended that "governmental claims should be subjected to the same requirements as other claims". S. Rep. No. 1916, 75th Cong., 3d Sess., at 5 (1938).

The Court's decisions following enactment of the Chandler Act were consistent with the stated intention of Congress as set forth in the legislative history that tax claims should be treated no differently from other claims. In *City of New York v. Saper*, 336 U.S. 328 (1949), for example, the Court considered whether tax claims should bear interest only until the date of the bankruptcy or until payment. The Court noted that nothing in the Bankruptcy Act expressly "permitt[ed] post-bankruptcy interest on other claims in general or tax claims in particular." *Id.* at 331. Emphasizing the Chandler Act's sweeping amendments to the Bankruptcy Act, the Court held that there was no basis for treating tax

claims differently from any other claims with respect to the disallowance of post-petition interest:

> Section 57, sub. n, 11 U.S.C. § 93, sub. n, 11 U.S.C.A. § 93, sub. n, requires governmental claims to be proved in the same manner and within the same time as other debts and only for cause shown may a reasonable extension be granted. Tax claims are treated the same as other debts except for the fourth priority of payment, § 64, sub. a, 11 U.S.C. § 104, sub. a, 11 U.S.C.A. § 104, sub. a, and the provision making taxes nondischargeable, § 17, 11 U.S.C. § 35, 11 U.S.C.A. § 35.
>
> The Court of Appeals concluded that by the 1926 amendment and the Chandler Act, Congress assimilated taxes to other debts for all purposes, including denial of post-bankruptcy interest. We think this is a sound and logical interpretation of the Act after those amendments to §§ 64, sub. a, and 57, sub. n.

Id. at 332, 337-38. *See also Nicholas v. United States*, 384 U.S. 678, 682 n.10 (1966) (*Saper* "reflected an assimilation of tax debts to the status of other debts in bankruptcy.... [I]n the light of these amendments, tax debts had become sufficiently clothed with the characteristics of other bankruptcy debts to justify the application of the general rule in *Sexton* to suspend the accrual of interest on such claims on the date the petition in bankruptcy was filed.").

The Bankruptcy Act as originally enacted did not address the allocation of the burden of production or the burden of persuasion in claim objection proceedings. Shortly after the Act was passed, the Court in *Whitney v. Dresser*, 200 U.S. 532 (1906), in an opinion by Justice Holmes, held that a properly filed proof of claim was *prima facie* evidence of the matters therein alleged:

> The only question warranting the appeal is whether the sworn proof of claim is prima facie evidence of its allegations in case it is objected to. It is not a question of the burden of proof in a technical sense, — a burden which does not change, whatever the state of the evidence, — but simply whether the sworn proof is evidence at all. ... We believe that the understanding of the profession, the words of the act, and convenient and just administration, all are on the side of treating a sworn proof of claim as some evidence, even when it is denied.

Id. at 534-36. *See also Gardner v. New Jersey*, 329 U.S. 565, 573 (1947) ("A proof of claim is, of course, prima facie evidence of its validity.").

In 1960, Congress codified *Whitney* and amended section 57a of the Bankruptcy Act to provide that "[a] proof of claim filed in accordance with the requirements of the Bankruptcy Act, the General Orders of the Supreme Court, and the official forms, even though not verified under oath, shall constitute prima facie evidence of the validity and amount of the claim." Pub. L. No. 86-519, 74 Stat. 217 (1960) (codified as amended at 11 U.S.C. § 93a). The *prima facie* evidentiary effect of a properly filed proof of claim was subsequently incorporated into Bankruptcy Rule 301(b): "(b) *Evidentiary Effect.* A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim."

Against this legislative framework and the Court's decisions regarding the treatment to be afforded tax claims in bankruptcy, the vast majority of lower courts adjudicating objections to tax claims under the Bankruptcy Act imposed the same burden of persuasion on taxing authorities that was imposed on other creditors. Irrespective of the burden of persuasion under state or federal tax laws, these courts held that the burden of persuasion remained with the taxing authorities as creditors to establish their tax claims. *See, e.g., United States v. Sampsell*, 224 F.2d 721, 722–23 (9th Cir. 1955) ("In this connection we quote from 3 Collier on Bankruptcy, 3d ed. p. 2173: '... a sworn proof of a tax claim in proper form establishes a prima facie case for the

allowance of the claim. The burden of proof is on the claimant, but the burden of going forward and introducing evidence to rebut the prima facie case is on the objecting party.'"); *In re Bradley*, 16 F.2d 301, 302 (S.D.N.Y. 1926) ("The filing of the sworn proofs of claims by the city [for taxes] amounted to prima facie cases, and no additional proof was required to be produced, unless some evidence contradicting it was produced by the objector."); *In re Avien, Inc.*, 390 F. Supp. 1335, 1341-42 (E.D.N.Y. 1975) ("While the burden of proof with respect to deductions claimed is normally on the taxpayer [citations omitted], that is not the case in bankruptcy proceedings where the burden of establishing its claim rests on the government.... The government is aided, however, by a strong presumption which arises in its favor by the filing of a sworn proof of claim; a *prima facie* case is established and the burden of going forward with rebutting evidence is on the debtor....The ultimate burden of persuasion remains on the government."), *aff'd*, 532 F.2d 273 (2d Cir. 1976); *Matter of Seafarer Fiber Glass Yachts, Inc.*, 475 F. Supp. 1097, 1099 (E.D.N.Y. 1979) (quoting *Avien* with approval); *Watson v. Thompson*, 456 F. Supp. 432, 435 (S.D. Ga. 1978) ("The introduction by the Government of its claim in the instant case shifted to the [debtors] the burden of rebutting its correctness. Of course, the ultimate burden of persuasion remains with the United States."); *In re Gorgeous Blouse Co.*, 106 F. Supp. 465, 465 (S.D.N.Y. 1952) ("There is no doubt that the burden of establishing the claim rests upon the Government."); *In re Slodov*, 1975-2 U.S. Tax Cas. (CCH) ¶ 9829, at 88,653 (N.D. Ohio 1975) ("The Court finds that the burden of proof is properly placed on the Government when it seeks to collect a tax. The assessment of taxes is sufficient to establish a prima facie case forcing the debtor to go forward with evidence to rebut, but the United States as a claimant seeks [sic] to collect taxes has the burden of proof."), *rev'd on other grounds sub. nom. Slodov. v. United States*, 552 F.2d 159 (6th Cir. 1977), *rev'd*, 436 U.S. 238 (1978); *Fiori v. Rothensies*, 99 F.2d 922, 922 (3d Cir. 1938); *Dickinson v. Riley*, 86 F.2d

385, 387-88 (8th Cir. 1936); *In re Highway Constr. Co. of Ohio*, 105 F.2d 863, 866 (6th Cir. 1939); *In re Wolslagel*, 104 F. Supp. 68, 76-77 (N.D. Ohio 1952); *In re Estrada's Market*, 222 F. Supp. 253, 255 (S.D. Cal. 1963); *In re Clayton Magazines*, 77 F.2d 852, 854 (2d Cir. 1935); *In re Koscot Interplanetary, Inc.*, 1977-2 U.S. Tax Cas. (CCH) ¶ 9497, at 87,620 (M.D. Fla. 1977). *See also* 3A J. Moore & L. King, *Collier on Bankruptcy*, ¶ 64.409 at 2244-45 (14th Ed. 1975) ("As in the case of other types of claims, a filed proof of a tax claim in proper form establishes a *prima facie* case for the allowance of the claim. The burden of proof is on the claimant, but the burden of going forward and introducing evidence to rebut the *prima facie* case is on the objecting party.").[5]

B.

The Bankruptcy Code of 1978

The Bankruptcy Code enacted in 1978, like the Bankruptcy Act of 1898, contains no specific provisions addressing the allocation of the burden of persuasion in claim objection proceedings.[6] In drafting the Bankruptcy Code,

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[5] A small minority of cases placed the burden of persuasion on the taxpayer/debtor. *E.g.*, *Paschal v. Blieden*, 127 F.2d 398, 401-02 (8th Cir. 1942); *In re Oxford Assocs.*, 209 F. Supp 242, 243-44 (D.N.J. 1962); *Matter of Uneco, Inc.*, 532 F.2d 1204, 1207 (8th Cir. 1976); *In re Lang Body Co.*, 92 F.2d 338, 341 (6th Cir. 1937); *In re Raflowitz*, 37 F. Supp. 202, 207 (D. Conn. 1941). Cases such as *In re Garfield Bag & Stationery Co.*, 42 F. Supp. 708, 710-11 (S.D.N.Y. 1941), and *In re Glotzer*, 42 F. Supp. 712, 713 (S.D.N.Y. 1941), required the objecting party to rebut the presumptive validity of tax assessment claims by clear and convincing evidence.

[6] Section 501(a) provides that "[a] creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest." 11 U.S.C. § 501(a). Section 502(a) provides that "[a] claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner

however, Congress was not writing on a clean slate, *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992), and was presumably aware of the prevailing judicial construction of the Bankruptcy Act that placed the burden of persuasion on taxing authorities. The legislative history of the Bankruptcy Code evidences that Congress was also aware of the tension between taxing authorities, other creditors, and the debtor and the need to balance those competing interests:

> The bill contains a series of provisions dealing with the priority, discharge, and collection of tax claims in bankruptcy. The writing of provisions dealing with the collection of taxes, at the Federal, State, and local levels has presented one of the most difficult problems for the committee. In a broad sense, the goals of rehabilitating debtors and giving equal treatment to private voluntary creditors must be balanced with the interests of governmental tax authorities who, if unpaid taxes exist, are also creditors in the proceeding.

S. Rep. No. 95-989, at 13-14 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5799-5800. The legislative history indicates that, in drafting the Bankruptcy Code, Congress attempted to balance the

> three-way tension ... among (1) general creditors, who should not have the funds available for payment of debts exhausted by an excessive accumulation of taxes for past years; (2) the debtor, whose "fresh start" should likewise not be burdened with such an accumulation; and (3) the tax collector, who should not lose taxes which he has not had reasonable time to collect or which the law has restrained him from collecting.

Id.

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in a partnership that is a debtor in a case under chapter 7 of this title, objects." 11 U.S.C. § 502(a).

In "balanc[ing] [those] interests", Congress gave taxing authorities a priority for most tax claims, 11 U.S.C. § 507(a), and provided that priority and certain other tax claims were non-dischargeable, 11 U.S.C. § 523(a)(1). *Id.* Congress also gave tax claims special treatment in the context of plan confirmation. 11 U.S.C. §§ 1129(a)(1)(C) and 1129(d). Congress inserted various other provisions in the Bankruptcy Code (and declined to include others[7]) in order to "minimize the administrative problems governmental tax authorities face, or may face, in collecting taxes in bankruptcy proceedings." S. Rep. No. 95-989, at 14-15 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5800-01.

Although the Bankruptcy Code contains no specific provisions addressing the burden of persuasion in claim objection proceedings, the legislative history suggests that Congress did not intend to deviate from the established pre-Code practice of placing the burden of persuasion on all creditors, including taxing authorities. Comments in both the Senate and House Reports discuss claim objection proceedings in terms that mimic the practice under the Act:

> A proof of claim or interest is prima facie evidence of the claim or interest. Thus, it is allowed under subsection (a) [of section 502] unless a party in interest objects.... The burden of proof on the issue of allowance is left to the Rules of Bankruptcy Procedure.

H.R. Rep. No. 95-595, at 352 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6308; S. Rep. No. 95-989, at 62 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848. Federal Rule of Bankruptcy Procedure 3001(f), prescribed by this Court in

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[7] The Senate bill rejected a provision found in the House bill which would have required a taxing authority to file a proof of claim for taxes arising out of a taxable sale made by a bankruptcy trustee, "since in these situations, the trustee has better knowledge than the tax authority of the existence of such a liability for taxes." S. Rep. No. 95-989, at 15 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5801.

1983, restates verbatim former Rule 301(b): "*(f) Evidentiary Effect.* A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f).

Thus, although Congress did numerous things in the Bankruptcy Code to give preferential treatment to taxing authorities, one thing it did not do — and, the legislative history suggests, consciously chose not to do — was provide an exception for taxing authorities to the general rules regarding burdens of persuasion in claim objection proceedings. Congress' inclusion of specific burdens of persuasion in other parts of the Bankruptcy Code (*e.g.*, 11 U.S.C. §§ 362(g), 363(o), 364(d)(2), 547(g), 1129(a)(9)(C) and 1129(d)) supports the conclusion that Congress did not intend for taxing authorities to benefit from an exception to the general burdens of persuasion applicable to all other creditors in claim objection proceedings. In *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), the Court discussed the special treatment — and the absence of special treatment — given to tax claims by Congress in the Code:

> Congress carefully considered the effect of the new Bankruptcy Code on tax collection, see generally S. Rep. No. 95-1106 (1978) (Report of Senate Finance Committee), and decided to provide protection to tax collectors, such as the IRS, through grants of enhanced priorities for unsecured tax claims, § 507(a)(6), and by the nondischarge of tax liabilities, § 523(a)(1). S. Rep. No. 95-989, pp. 14-15 (1978). Tax collectors also enjoy the generally applicable right under § 363(e) to adequate protection for property subject to their liens. Nothing in the Bankruptcy Code or its legislative history indicates that Congress intended a special exception for the tax collector in the form of an exclusion from the estate of property seized to satisfy a tax lien.

Id. at 209. *See also United States v. Energy Resources Co.*, 495 U.S. 545, 549-50 (1990) (bankruptcy court's exercise of

equitable powers did not "conflict with the Code's provisions protecting the Government's ability to collect delinquent taxes," because the result sought by the government was "an added protection not specified in the Code itself.").

Given the legislative history of the Bankruptcy Code, and Congress' inclusion of specific burdens of persuasion elsewhere in the Code, Congress' silence on the applicable burden of persuasion in claim objection proceedings should not be interpreted as a decision by Congress to depart from established practices under the Bankruptcy Act. *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) ("We, however, 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure....'"); *Pennsylvania Dep't of Public Welfare v. Davenport*, 495 U.S. 552, 563 (1990) (same). Had Congress intended to depart from this Court's determinations that "governmental claims [are] to be proved in the same manner and within the same time as other debts", *City of New York v. Saper*, 336 U.S. 328, 332 (1949), and that tax debts had been "assimilat[ed] ... to the status of other debts in bankruptcy [and were] clothed with the characteristics of other bankruptcy debts", *Nicholas v. United States*, 384 U.S. 678, 682 n.10 (1966), and had Congress wanted to change the pre-Code practice of allocating the burden of persuasion to taxing authorities, "one would expect Congress to have made unmistakably clear its intent," *Cohen v. De La Cruz*, 523 U.S. 213, 222 (1998), rather than relegate burden of proof issues to the Bankruptcy Rules. *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.*, 474 U.S. 494, 501 (1986) ("The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications."); *United Savs. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 380 (1988) ("If it is at all relevant, the legislative history tends to subvert rather than support petitioner's thesis, since it contains not a hint that § 362(d)(1) entitles the undersecured

creditor to postpetition interest. Such a major change in the existing rules would not likely have been made without specific provision in the text of the statute... it is most improbable that it would have been made without even any mention in the legislative history.").

The pre-Code practice of affording tax claims the same treatment as other claims (in the absence of specific statutory provisions to the contrary) generally has been continued by the Court in cases decided under the Bankruptcy Code. The practice of treating tax claims like other claims sometimes works to the advantage of the taxing authority, sometimes not. In *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), the Court held that, like any other creditor, the IRS was entitled to post-petition interest on an over-secured tax lien under section 506(b) of the Bankruptcy Code. 11 U.S.C. § 506(b). Seeing "no reason why a different result should obtain when the IRS is the creditor", the Court in *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), found that "[n]othing in the Bankruptcy Code or its legislative history indicates that Congress intended a special exception for the tax collector in the form of an exclusion from the estate of property seized to satisfy a tax lien." *Id.* at 209.

The established practice under the Bankruptcy Act, the absence of any language in the Bankruptcy Code or its legislative history indicating that Congress intended to deviate from that practice, and the Court's treatment of tax claims under the Code in a manner consistent with the treatment of the claims of other creditors, support the conclusion that taxing authorities should bear the same burden of persuasion as other creditors in claim objection proceedings.

II.

THE *ERIE* DOCTRINE DOES NOT APPLY, AND POLICIES UNDERLYING THE BANKRUPTCY CODE MANDATE A UNIFORM ALLOCATION OF THE BURDEN OF PERSUASION IN CLAIM OBJECTION PROCEEDINGS

The Court has often been called upon to determine various standards and procedures under the Bankruptcy Act and the Bankruptcy Code that had not been specifically addressed by Congress:

> Congress has often left the exact scope of summary proceedings in bankruptcy undefined, and this Court has elsewhere recognized that in the absence of congressional definition this is a matter to be determined by decisions of this Court after due consideration of the structure and purpose of the Bankruptcy Act as a whole, as well as the particular provisions of the Act brought in question.

Katchen v. Landy, 382 U.S. 323, 328 (1966). This is one of those times.

The allowance or disallowance of a tax claim (or any claim) in a bankruptcy estate is fundamentally different from the adjudication of the underlying tax liability in the absence of a bankruptcy proceeding. *Wiswall v. Campbell*, 93 U.S. 347, 350 (1876). Outside of bankruptcy, the only parties to the adjudication of a tax liability are the taxing authority and the taxpayer. The interests of other parties are not at stake and any impact on other creditors of the taxpayer is incidental at best. Once the taxpayer becomes a debtor in bankruptcy, however, the dispute is no longer solely between the taxing authority and the debtor. Rather, the primary battle is

between the taxing authority and the debtor's other creditors[8] as they vie for a share of a limited pool of assets that make up a bankruptcy estate.[9] Courts adjudicating tax claims outside of bankruptcy are not confronted with "the special bankruptcy problems of uniformity, ratable distribution and fairness and equity which grow out of the context of the bankruptcy law." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 165 n.9 (1946). Thus, the considerations that determine state law burdens of persuasion that govern resolution of tax liabilities outside of bankruptcy — where only the taxing authority and the taxpayer are interested parties — should not apply to the adjudication of objections to the allowance of tax claims under section 502 of the Bankruptcy Code.

Diversity jurisdiction does not bring into federal court objections to the allowance of tax claims in bankruptcy estates — federal question jurisdiction does. Accordingly, and contrary to the court of appeals' reasoning, bankruptcy courts are not bound under *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), to apply state law burdens of persuasion to claim objection proceedings under section 502 of the Bankruptcy Code. *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946).

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[8] Creditors, as "parties in interest", 11 U.S.C. § 502(a), have standing to file objections to claims filed by other creditors.

[9] Claims are not filed against the debtor but filed against the assets of the bankruptcy estate. "The Bankruptcy Act...converts the creditor's legal claim into an equitable claim to a pro rata share of the *res*." *Katchen v. Landy*, 382 U.S. 323, 336 (1966). *See also Gardner v. New Jersey*, 329 U.S. 565, 574 (1947) ("The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a res."); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 57 (1989) ("Our decision [in *Katchen*] turned, rather, on the bankruptcy court's having 'actual or constructive possession' of the bankruptcy estate, ... and its power and obligation to consider objections by the trustee in deciding whether to allow claims against the estate."); *Local Loan Co. v. Hunt*, 292 U.S. 234, 241 (1934) ("[G]enerally, proceedings in bankruptcy are in the nature of proceedings in rem....").

In *Vanston*, the indenture trustee on the debtor's first mortgage bonds sought interest on interest on its secured claim pursuant to the language of the indenture. 329 U.S. at 159. Because allowing interest on interest would greatly reduce the amount paid to subordinate creditors, the creditors lodged a challenge. *Id.* The indenture trustee argued that the claim to interest on interest was valid and enforceable under applicable non-bankruptcy law and, therefore, must be allowed in the bankruptcy estate. *Id.* at 160. The Court disagreed:

> A purpose of bankruptcy is so to administer an estate as to bring about a ratable distribution of assets among the bankrupt's creditors. What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed, is a question which, in the absence of overruling federal law, is to be determined by reference to state law....But we need not decide which, if either, of these two states' laws govern the creation and subsistence and validity of the obligation for interest on interest here involved. For assuming, arguendo, that the obligation for interest on interest is valid under the law of New York, Kentucky, and the other states having some interest in the indenture transaction, we would still have to decide whether allowance of the claim would be compatible with the policy of the Bankruptcy Act.... In determining what claims are allowable and how a debtor's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits. *Erie R. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, 114 A.L.R. 1487, has no such implication....[B]ankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles. And we

> think an allowance of interest on interest under the circumstances shown by this case would not be in accord with the equitable principles governing bankruptcy distributions.

Id. at 161-63. *See also Heiser v. Woodruff*, 327 U.S. 726, 732 (1946) ("For nothing decided in *Erie R. Co. v. Tompkins*, supra, requires a court of bankruptcy, in applying the statutes of the United States governing the liquidation of bankrupts' estates, to adopt local rules of law in determining what claims are provable, or to be allowed, or how the bankrupt's estate is to be distributed among claimants."); *Local Loan Co. v. Hunt*, 292 U.S. 234, 244-45 (1934) ("We find it unnecessary to consider this contention ... since we are of the opinion that it is precluded here by the clear and unmistakable policy of the Bankruptcy Act.... [W]e reject the Illinois decisions as to the effect of an assignment of wages earned after bankruptcy as being destructive of the purpose and spirit of the Bankruptcy Act.").

The Court's decision in *Grogan v. Garner*, 498 U.S. 279 (1991), sheds further light on the interplay between state and federal burdens of proof in claim objection proceedings. The question in *Grogan* was whether a creditor had to prove fraud by clear and convincing evidence or by a preponderance of the evidence in order to have its claim excepted from the debtor's discharge under section 523(a) of the Bankruptcy Code. 11 U.S.C. § 523(a). While the Court cited *Vanston* as support for the proposition that "[t]he validity of a creditor's claim is determined by rules of state law," *id.* at 283, the Court determined that the question whether the claim was excepted from discharge under section 523(a) of the Bankruptcy Code was a question of federal law to which federal burdens of proof applied. *Id.* at 284. So too in the instant case. While state law burdens of persuasion govern the validity of the Department's claim outside of bankruptcy, the question of the allowance of that claim under section 502 of the Bankruptcy Code is a question of federal law to which federal burdens of persuasion should apply. *Citizens Bank of*

Maryland v. Strumpf, 516 U.S. 16, 19 (1995) ("But even if state law were different, the question whether a setoff *under § 362(a)(7)* has occurred is a matter of federal law.").

The Court's decisions in *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983), *United States v. Noland*, 517 U.S. 535 (1996), *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213 (1996), and *Butner v. United States*, 440 U.S. 48 (1979), relied upon by the court of appeals, do not dictate a different result.

In *Whiting Pools*, the Court specifically declined to grant the IRS special treatment that was not provided for in the Bankruptcy Code:

> Nothing in the Bankruptcy Code or its legislative history indicates that Congress intended a special exception for the tax collector in the form of an exclusion from the estate of property seized to satisfy a tax lien.

462 U.S. at 209. *Noland* involved the ability of a bankruptcy court to equitably subordinate a class of claims in derogation of the specific priority schemes established by Congress. There is no express statutory provision dealing with the allocation of the burden of persuasion in claim objection proceedings, and placing the burden of persuasion on the Department does not deprive the Department of any entitlements "provided by the Bankruptcy Code itself." (Pet. App. A9). In *Reorganized CF & I Fabricators*, the Court held that a claim filed by the government under 26 U.S.C. § 4971(a) for a 10% "tax" on pension plan underfunding was not entitled to priority treatment as an "excise tax" under 11 U.S.C. § 507(a)(7)(E). The Court found that characterization of the claim as a "tax" claim under non-bankruptcy law did not mandate treatment of the claim as a "tax" claim under section 507(a)(7)(E) of the Bankruptcy Code. 518 U.S. at 224. Similarly, in the instant case, the state law burden of persuasion governing adjudication of tax liabilities outside of bankruptcy does not dictate the burden of persuasion that

should apply to adjudication of objections to the allowance of tax claims under section 502 of the Bankruptcy Code.

In *Butner*, the Court held that whether the lien created by a mortgage extends to rents and profits from the encumbered property was a matter of state law. 440 U.S. at 56. The Court reasoned that "[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 55. In the instant case, the issue before the Court is not the determination of a creditor's property interest in specific assets of the bankruptcy estate. Given the Court's statements in *Vanston* that allowance of claims under section 502 of the Code is a matter of federal law to which the *Erie* doctrine does not apply, the bankruptcy court is not bound to apply state law burdens of persuasion.

Pursuant to the general principle that "burden of proof allocations are governed by principles of fairness, common sense and logic," *First National Bank of Louisville v. Hurricane Elkhorn Coal Corp. II*, 763 F.2d 188, 190 (6th Cir. 1985) (*citing* 9 J. Wigmore, *Evidence in Trials at Common Law*, § 2486 at 290 (rev. ed. 1981)), the burden of persuasion on the adjudication of an objection to the allowance of a claim under section 502 of the Bankruptcy Code should be allocated in a manner that is consistent with federal policies underlying the Code. One of the fundamental policies underlying the Bankruptcy Code is "equality of distribution among creditors". *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (quoting H.R. Rep. No. 95-595, at 177-78 (1978), *reprinted in* 1978 U.S.C.C.A.N. 6137-38). *See Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another."); *Begier v. Internal Revenue Service*, 496 U.S. 53, 58 (1990) (creditors of equal priority should receive ratable shares of the assets of the estate). *See also In re Schimmelpenninck*, 183 F. 3d 347, 351

(5th Cir. 1999) ("the interests of all creditors ... are to be put on a level playing field with like–situated claimants being treated equally").

The Bankruptcy Code's fundamental goal of equality of treatment of creditors is put at risk if one class of creditors – and indeed, a class of creditors whose claims are often granted priority status – is given the benefit of a favorable presumption that is unavailable to other creditors.[10] *In re Wilhelm*, 173 B.R. 398, 402 (Bankr. E.D. Wis. 1994). When the burden of proof is placed on the objecting party, tax claims are not "treated the same as other debts for all purposes," *City of New York v. Saper*, 336 U.S. 328, 332 (1949), and tax claims are not "assimilated ... to the status of other debts in bankruptcy...[and] clothed with the characteristics of other bankruptcy debts." *Nicholas v. United States*, 384 U.S. 678, 682 n.10 (1966).

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[10] Policy reasons typically given for allocating the burden of persuasion to taxpayers outside of bankruptcy -- to encourage record keeping and because the debtor has better knowledge of its own financial affairs and better access to relevant evidence, *Psaty v. United States*, 442 F.2d 1154, 1160 (3d. Cir. 1971) -- are not disserved by placing the burden of persuasion on taxing authorities in a bankruptcy proceeding. Under the Code, individual debtors who do not maintain adequate records or who fail to turn over records may be denied a discharge. 11 U.S.C. §§ 727(a)(3), 727(a)(4)(D). A debtor's failure to maintain adequate books and records is also one of the factors considered by bankruptcy courts in determining whether "cause" exists for the appointment of a Chapter 11 trustee under section 1104 of the Code, 11 U.S.C. § 1104. *See In re Paolino*, 53 B.R. 399, 401 (Bankr. E.D. Pa. 1985) ("Due to the importance of this duty courts have held that when current management has failed to keep accurate financial records prior to the filing of the petition or has failed to file with the court the requisite operating statements after the filing of the petition, cause for the appointment of a trustee under §1104(a)(1) is present."), *aff'd*, 60 B.R. 828 (E.D. Pa. 1986). Moreover, objecting creditors, trustees, or creditors' committees often have no better understanding of the debtor's finances and no better access to crucial evidence than does the taxing authority. Finally, if the objecting party cannot proffer sufficient evidence to rebut the presumption of validity of the taxing authority's proof of claim, the claim will be allowed.

The taxes sought by the Department were exempt from the debtor's discharge under section 523(a)(1) of the Code, 11 U.S.C. § 523(a)(1). The Department could have sought payment of those taxes from Stoecker personally outside of the bankruptcy proceeding without ever having filed a proof of claim. *Id.* By filing a proof of claim in the bankruptcy estate, however, the Department has sought to satisfy its claim out of the assets of the estate, has subjected itself to the equitable jurisdiction of the bankruptcy court,[11] and is subject to the rules and procedures that govern all creditors:

> It is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure.... When the State becomes the actor and files a claim against the fund it waives any immunity which it otherwise might have had respecting the adjudication of the claim.

Gardner v. State of New Jersey, 329 U.S. 565, 573 (1947) (citing *Wiswall v. Campbell*, 93 U.S. 347, 351 (1876)). *See also Langenkamp v. Culp*, 498 U.S. 42, 44 (1990); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 58 & n.14 (1989); *Alexander v. Hillman*, 296 U.S. 222, 241 (1935); *New York v. Irving Trust Co.*, 288 U.S. 329, 333 (1933).

In *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), the Court reaffirmed its decision in *Vanston* that the

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[11] Bankruptcy courts are "essentially courts of equity, and their proceedings inherently proceedings in equity," *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934), and "the expressly granted power to 'allow', 'disallow' and 'reconsider' claims ... is of 'basic importance in the administration of a bankruptcy estate....'" *Katchen v. Landy*, 382 U.S. 323, 329 (1966) (quoting *Gardner v. State of New Jersey*, 329 U.S. 565, 573 (1947)). The ability of a bankruptcy court as a court of equity to adjudicate objections to claims includes "full power to inquire into the validity of any alleged debt or obligation of the bankrupt upon which a demand or claim against the estate is based." *Lesser v. Gray*, 236 U.S. 70, 74 (1915). *See also* 28 U.S.C. § 157(b)(2)(B) ("allowance or disallowance of claims against the estate" is a core proceeding).

"touchstone of each decision on allowance of interest in bankruptcy ... has been a balance of equities between creditor and creditor or between creditors and the debtor." *Id.* at 248 (*citing Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 165 (1946)). That same "balance of equities between creditor and creditor[s]" is at work when a bankruptcy court is called upon to adjudicate an objection to the allowance of a priority tax claim under section 502 of the Bankruptcy Code. Every other creditor who files a claim in a bankruptcy estate — including creditors holding claims in the seven categories of priority claims that enjoy higher statutory priorities than tax claims — bears the burden of persuasion on its claim. In order to balance the equities between taxing authorities and other creditors, taxing authorities should shoulder the same burden of persuasion as other creditors to establish their claims.

CONCLUSION

For the reasons stated above, petitioner respectfully requests that the judgment of the court of appeals be reversed.

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In the

Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee for the Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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QUESTION PRESENTED

Whether the burden of proof that applies to government tax claims in state court—a burden that substantive tax law ordinarily places on the taxpayer to disprove his liability—is reversed and falls on the government when the government brings a tax claim in the bankruptcy court.

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STATEMENT OF THE CASE

1. Chandler Enterprises and Stoecker

William J. Stoecker was the president and a director of Chandler Enterprises, Inc., an Illinois corporation. (P.A. A-2, C-18).[1] Chandler's officers included Lawrence Pluhar, who also served as an officer of other corporations involving Stoecker. (B.R. vol. 4, J. Prewitt Dep., Ex. 2; B.R. 1992 Tr. at 125, 131). According to Chandler's counsel, Pluhar acted "like his [Stoecker's] chief financial officer." (B.R. 1992 Tr. at 125). Other than that single comment, there is no evidence of the duties Stoecker or Pluhar performed for Chandler. Nor is there any evidence about the nature of Chandler's business. The Illinois Secretary of State involuntarily dissolved Chandler in 1990. (P.A. E-4).

Chandler was one of many companies in a larger Stoecker business empire. (B.R. vol. 3, 1154A-B, Ex. C). A federal grand jury eventually indicted Stoecker and Pluhar for mail, wire and bank fraud in connection with these companies, alleging that Chandler and several other companies were mere shells with no substantial assets, value, income, or business operations. (*Id.* at 4). Stoecker and Pluhar were subsequently convicted. *United States v. William Stoecker, et al.*, No. 95 CR 118 (N.D. Ill.

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[1] The appendix to the petition for writ of certiorari is cited as "P.A." The bankruptcy court record is cited as "B.R." Because some items in the bankruptcy court record are not numbered, references to the record will cite to the volume and to the item number where possible. The 1992 hearing transcript (cited as "1992 Tr.") appears in volume 5.

March 4, 1997). Stoecker's appeal of his conviction is pending. *United States v. William Stoecker, et al.*, No. 97-3870 (7th Cir.).[2]

2. Chandler's Purchase of the Aircraft

In early 1988, Chandler decided to purchase a corporate jet and hired an aircraft broker to locate a jet for sale. (P.A. A-2). The broker found a Dassault Falcon 50 in the possession of an Australian company. (P.A. A-2, C-15).

Because Chandler was unable to pay the full $12 million purchase price, the broker's leasing company financed the sale on an interim basis, entering into an aircraft lease/purchase agreement with Chandler. (P.A. A-2). Stoecker signed the agreement as Chandler's president. (P.A. C-51). Chandler paid the leasing company $2.5 million and took delivery of the aircraft, transferring it to Illinois. (P.A. A-2). Several months later, Chandler obtained financing from NEMLC Leasing Corporation and paid the balance of the purchase price. (P.A. A-2-3, C-16). Title to the aircraft was transferred to Chandler. (P.A. A-3).

In connection with the purchase, NEMLC sought a legal opinion from Chandler about the taxability of the transaction under Illinois law. (B.R. 1992 Tr. at 125). Chandler's counsel wrote a letter to NEMLC opining that the sale was an "occasional sale" not subject to Illinois

[2] The Court can take judicial notice of related litigation. *National Fire Ins. Co. v. Thompson*, 281 U.S. 331, 336 (1930).

use tax. (P.A. C-16-17). Although a copy of the letter was sent to Pluhar and was also included in the closing book that Pluhar received (P.A. C-56; B.R. 1992 Tr. at 130-31), there is no evidence that Stoecker ever saw the letter (P.A. A-8). No opinion letter was issued to Chandler or to Stoecker himself. (P.A. C-55; B.R. 1992 Tr. at 136).

Following the closing, Chandler registered the aircraft with the Federal Aviation Administration at an address in Oak Forest, Illinois (B.R. 1992 Tr. at 33), but never registered it with the Illinois Department of Transportation, as Illinois law required, *see* Ill. Rev. Stat. ch. 15½, ¶ 22.42 (1989). (P.A. C-15). No certificate of registration could have been issued without proof either that Illinois use tax had been paid or that no tax was due. (P.A. A-12).

3. The Illinois Use Tax

The Illinois "sales tax" scheme consists of two taxes: a retailer's occupation tax, Ill. Rev. Stat. ch. 120, ¶¶ 440-53 (1989), and a use tax, Ill. Rev. Stat. ch. 120, ¶¶ 439.1-.22 (1989). The occupation tax is a tax "upon persons engaged in the business of selling personal property" in Illinois. Ill. Rev. Stat. ch. 120, ¶ 441 (1989). The use tax is a complementary tax "upon the privilege of using in this State tangible personal property," regardless of whether the property is purchased in Illinois. Ill. Rev. Stat. ch. 120, ¶ 439.3 (1989).

Unlike the occupation tax, the use tax is imposed on the purchaser of property. Retailers in Illinois, and foreign retailers with an adequate nexus to Illinois, must collect the tax and remit it to the Department. Ill. Rev.

Stat. ch. 120, ¶ 439.3 (1989). However, any tax "not paid to a retailer . . . shall be paid to the Department directly by any person using such property within this State." *Id.* Purchasers from a retailer who does not pay the tax must file a return with the Department and pay the tax themselves. Ill. Rev. Stat. ch. 120, ¶ 439.10 (1989).

If no return is filed, the Department determines the tax due and issues a Notice of Tax Liability ("NTL") to the taxpayer. Ill. Rev. Stat. ch. 120, ¶ 444 (1989). The taxpayer may protest the assessment and request a hearing. *Id.* If no protest is filed, however, the NTL becomes a final assessment. *Id.* Decisions of the Department, including final assessments, are subject to administrative review in the Illinois courts. Ill. Rev. Stat. ch. 120, ¶¶ 444, 451 (1989).

When a corporation fails to pay use tax it owes, responsible officers and employees of the corporation may be held liable for a penalty equal to the unpaid tax:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed . . . and who wilfully fails to file such return or make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon . . . .

Ill. Rev. Stat. ch. 120, ¶ 452½ (1989).[3] If the Department determines that a penalty should be imposed, the Department issues a notice of penalty liability ("NPL") to the officer or employee. *Id.* As with an NTL, the officer or employee subject to an NPL can seek an administrative hearing and pursue administrative review in the Illinois courts. *Id.*

Once the Department has issued an NPL to a corporate officer or employee, the NPL is deemed "prima facie correct" and "prima facie evidence of [the] penalty due." Ill. Rev. Stat. ch. 120, ¶ 452½ (1989). Upon proof of the NPL, the burden falls on the officer or employee to prove he is not liable for the penalty assessment. *Branson v. Department of Revenue,* 168 Ill. 2d 247, 659 N.E.2d 961 (1995). The burden is not merely a burden of going forward. In *Branson,* the Illinois Supreme Court held that the ultimate burden of proof shifts to the taxpayer. The NPL establishes "a rebuttable presumption" that is rebutted only if the taxpayer can "adduce sufficient evidence to *disprove* willful failure to file returns and pay taxes." *Id.* at 262, 659 N.E.2d at 968 (emphasis added).

4. The Department's Claim

Chandler filed no use tax return with the Department and paid no use tax on its purchase of the aircraft. (P.A.

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[3] This provision appeared in the Retailer's Occupation Tax Act and was incorporated into the Use Tax Act. Ill. Rev. Stat. ch. 120, ¶ 439.12 (1989). The provision was later repealed and recodified as part of the Uniform Penalty and Interest Act. 35 ILCS 735/3-7 (1994).

A-4, B-2). In fact, Chandler never filed Illinois tax returns of any kind and was not registered with the Department in any capacity. (P.A. C-18, D-3). The Department knew nothing of Chandler or the aircraft it purchased.

In 1989, Stoecker's creditors initiated an involuntary proceeding against him under chapter 11 of the Bankruptcy Code. (P.A. C-12). Thomas E. Raleigh was appointed trustee. (*Id.*). The proceeding was later converted to a liquidation under chapter 7, and in 1990 Stoecker was denied a discharge. (*Id.*).

In early 1989, the Department was notified about Stoecker's bankruptcy. (P.A. C-13). The Department's bankruptcy unit researched Stoecker and filed claims against him in the bankruptcy as the responsible officer of several corporations. (P.A. C-13-14, D-3, E-3). Because Chandler was not a registered taxpayer, however, the Department did not learn about Chandler or link Chandler to Stoecker and the bankruptcy. (P.A. C-14, D-3).

A year later, a Department auditor in a different unit was reviewing F.A.A. records for unreported aircraft purchases when he happened on Chandler's purchase of the aircraft. (B.R. 1992 Tr. at 14-15, 52). The Department initiated an audit of the aircraft purchase and sent several letters to Chandler asking about it. (P.A. C-17, D-3; B.R. 1992 Tr. at 26-27, and Dep't Ex. 4). The letters went unanswered. (P.A. D-3; B.R. 1992 Tr. at 27).

Later in 1990, the Department issued an NTL to Chandler assessing the unpaid use tax on the purchase. (P.A. A-4, B-2). Chandler filed no protest (B.R. vol. 2, 1576, ¶ 2), and the assessment became final by operation

of law, *see* Ill. Rev. Stat. ch. 120, ¶ 444 (1989). There is no evidence that Chandler sought administrative review of the assessment in the Illinois courts.

After the NTL was issued, the Department made numerous attempts to collect the tax from Chandler. The collector tried unsuccessfully to contact Chandler but determined that Chandler was out of business. (B.R. vol. 2, 1576, ¶ 34; B.R. vol. 6, Towers Dep. at 54). He also repeatedly tried reaching Stoecker and Pluhar, both in person and by mail. (P.A. D-3; B.R. 1992 Tr. at 74-76). Neither responded. (P.A. D-3; B.R. vol. 6, Towers Dep. at 59).

The matter was referred to the Department's NPL unit (B.R. 1992 Tr. at 76), which in June 1991 issued an NPL to Stoecker as a responsible officer of Chandler, assessing a penalty equal to the unpaid use tax. (P.A. A-4, C-19). The NPL was sent to Stoecker by certified mail but was returned unclaimed. (B.R. 1992 Tr. at 92). Stoecker filed no protest (*id.* at 93), and the penalty assessment became final by operation of law, *see* Ill. Rev. Stat. ch. 120, ¶ 444 (1989). There is no evidence that Stoecker sought administrative review of the penalty assessment in the Illinois courts.[4]

In September 1991, the NPL unit sent Stoecker a demand for payment of the penalty. (P.A. D-4). In response, Stoecker's counsel had several telephone conversations

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[4] The Department also issued an NPL against Pluhar. (B.R. 1992 Tr. at 92-93). Unlike Stoecker, Pluhar protested the NPL, and after an administrative hearing the Department found he was not a responsible officer of Chandler. (*Id.* at 93).

with the NPL unit. (B.R. 1992 Tr. at 94-96). It was not until a conversation in January 1992, however, that he revealed to the NPL unit that Stoecker was in bankruptcy. (P.A. C-20; B.R. 1992 Tr. at 95-98). On January 21, 1992, the Department filed a proof of claim in the bankruptcy for the penalty, a claim later amended to $911,769: $868,351 in unpaid use tax and $43,418 in pre-petition interest. (P.A. C-20-21).

5. Proceedings Below

The Trustee objected to the Department's claim (P.A. C-22, D-4), and in 1996, after extensive litigation, the bankruptcy court disallowed the claim (P.A. C-1-82), finding that the Department had not met its burden of proving Stoecker a responsible officer of Chandler (P.A. C73-74). The court admitted that the NPL was *prima facie* evidence of liability but determined that under Bankruptcy Rule 3001(f) the Trustee's only obligation was to present evidence sufficient to rebut the presumption the NPL raised. (P.A. C-5, C-46, C-73). At that point, the burden shifted back to the Department, which the court said bore the "ultimate burden of proof." (P.A. C-73). The bankruptcy court concluded that the Department failed to meet that burden.

The Department appealed the bankruptcy court's decision (P.A. B-1), and the district court affirmed. (P.A. B-1-21). The district court conceded that in non-bankruptcy proceedings "the taxpayer bears the ultimate burden of proof" but held that in bankruptcy the tax law burden of proof no longer applied. (P.A. B-7-8). Relying on *In re Macfarlane*, 83 F.3d 1041 (9th Cir. 1996), the

court reasoned that "[c]reditors should be treated equally with respect to the required burden of proof." (P.A. B-8). The Department, the court said, should not be able to benefit from a burden of proof that "arises outside of bankruptcy law." (P.A. B-8-9). The district court agreed with the bankruptcy court that the burden had shifted to the Department and that the Department had not met its burden. (P.A. B-9-12).

The Department appealed to the Seventh Circuit, and the Seventh Circuit reversed, holding that the burden of proof under tax law applied in bankruptcy proceedings. (P.A. A-1-13). The court observed that bankruptcy is simply "a forum in which creditors prove the entitlements that state or federal law confers on them" and in which "these entitlements are enforced consistently with the provisions of the Code." (P.A. A-9). Because burdens of proof are substantive law, they are "rightly classified as a part of the creditor's entitlement." (P.A. A-10). And although Congress "can alter entitlements in bankruptcy, and sometimes does so, there is no indication that it meant to shift the burden of proof from taxpayer to tax collector." (P.A. A-11).

The court acknowledged that bankruptcy is an "equitable procedure" (P.A. A-8) but rejected the notion—apparently accepted in *Macfarlane*—that bankruptcy is a kind of "equity free-for-all," one in which judges can curtail or expand the rights based on "their personal notions of fairness." (P.A. A-9-10). Bankruptcy courts, the court declared, have no authority to "cut down the entitlements that creditors seek to enforce in bankruptcy except as provided by the Bankruptcy Code itself." (P.A.

A-9). The court went on to find that the Trustee bore the ultimate burden of proof, that he had not carried that burden, and that the Department's claim should have been allowed. (P.A. A7-8, 12).

SUMMARY OF ARGUMENT

The burden of proof that applies to tax claims brought in state court also applies to tax claims brought in bankruptcy court. Because rights and obligations adjudicated in bankruptcy come from state law, state law determines the rights of creditors in the assets of a bankruptcy estate. *Butner v. United States,* 440 U.S. 48, 54-55 (1979). One such state law right is the burden of proof applicable to a creditor's claim. Burdens of proof are substantive law, part of the claim itself. The burden of proof from tax law—where proof of a tax assessment usually shifts the burden to the taxpayer to disprove his liability—is accordingly the government's substantive right as a creditor.

The government does not lose that right when it files tax claims in bankruptcy. Although federal interests may displace state law in bankruptcy, the Bankruptcy Code and Rules do not address burdens of proof for claims. Nor is there a bankruptcy policy of "equality of treatment of creditors," as the Trustee asserts, shifting the burden of proof to the government. Bankruptcy policy contemplates only equal *distribution* of assets to similarly situated creditors. This case is about allowance of claims, not distribution of assets. In the allowance of claims, moreover, creditors are treated equally because each is entitled to

assert its state law rights, subject only to the requirements of the Code.

Far from identifying a concrete federal interest that displaces state law, the Trustee's argument for "equality" in the allowance of claims is a thinly-disguised invocation of the bankruptcy courts' equitable powers. The tax law burden of proof, he says, is unfair to private creditors who have no similar right, and bankruptcy courts should be able to level the playing field. Bankruptcy courts, however, can only exercise their equitable powers under the Code itself. They have no power to adopt uniform rules that alter the substantive state law rights of creditors out of a sense of "fairness."

The Trustee's historical argument for altering the burden of proof is equally flawed. First, practice under the former Bankruptcy Act is a tool of statutory construction, not an automatic gap-filler whenever the Code is silent. The Trustee has not asked the Court to construe any provision of the Code. Second, the Trustee has his history wrong. Although Congress increasingly subjected the claims of all creditors to the same *procedural* requirements, there was never a movement to alter government creditors' *substantive* state law rights. Nor was there an established judicial practice under the former Act of assigning to the government the burden of proof for tax claims. Bankruptcy history shows only that Congress has never specified a burden of proof for claims—not under the Act, and not under the Code.

Altering the burden of proof for tax claims will violate bankruptcy policy favoring uniform treatment of property interests between state courts and bankruptcy courts. It

will encourage taxpayers to litigate tax disputes in the bankruptcy courts rather than the state courts, despite Congressional concern that bankruptcy not become a refuge for tax delinquents. And it will disrupt state tax collection and necessitate changes in state tax law, contrary to the "strong background presumption against [federal] interference with state taxation." *National Private Truck Council v. Oklahoma Tax Comm'n,* 515 U.S. 582, 590 (1995). Nothing in federal law or policy compels these drastic results.

ARGUMENT

I. INTRODUCTION

The burden of proof that ordinarily applies to tax claims in state court does not shift to the government in bankruptcy court. The reasons why are not only fundamental but well-established. It is a basic premise of bankruptcy law that state law defines the rights of creditors in a bankruptcy estate. *Butner v. United States,* 440 U.S. 48, 54-55 (1979). It is just as basic that burdens of proof are substantive state law. *Garrett v. Moore-McCormack Co.,* 317 U.S. 239, 249 (1942). The burden of proof from state law is therefore a creditor's substantive right, a right that applies in the bankruptcy court unless some overriding federal interest requires a different result. There is no such federal interest.

The question here is not whether tax creditors like the Illinois Department of Revenue should be given some "advantage" (Pet. Br. at i) or "benefit" (*id.* at 27) in bankruptcy through a particular burden of proof, as the

Trustee asserts. The burden of proof for tax claims originates outside of bankruptcy, and whatever "advantage" tax creditors enjoy as a result is their substantive right under state law. Nor is the question whether creditors should be accorded "equality of treatment." (Pet. Br. at 27). Creditors are already treated equally in the allowance of claims because, except where the Code provides otherwise, all creditors come into bankruptcy with the same rights they had outside of bankruptcy.

The question in this case is whether tax creditors—unlike all other creditors—should be stripped of a substantive non-bankruptcy right and assigned some other, lesser right, when Congress has not seen fit to do so in the Code. The answer is no.

II. THE BURDEN OF PROOF FROM SUBSTANTIVE TAX LAW APPLIES WHEN TAX CLAIMS ARE FILED IN BANKRUPTCY PROCEEDINGS.

A. State Law Governs A Creditor's Rights In Bankruptcy Unless Some Federal Interest Dictates Otherwise.

The rights of creditors outside of bankruptcy are a matter of state law, not federal law. They continue to be a matter of state law in bankruptcy except where a federal interest displaces them.

The bankruptcy laws provide a forum and procedures to address the rights of creditors. *Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156, 171 (1946) (Frankfurter, J., concurring); Alfred Hill, *The Erie Doctrine in Bankruptcy,* 66 Harv. L. Rev. 1013, 1020 (1953). Unless the Code provides otherwise, however, the bank-

ruptcy laws do not create rights. "Parties are in a bankruptcy court with their rights and duties already established, except insofar as they subsequently arise during the course of bankruptcy administration or as part of its conduct." *Vanston,* 329 U.S. at 169 (Frankfurter, J., concurring); *see also Butner,* 440 U.S. at 54; Vern Countryman, *The Use of State Law in Bankruptcy Cases (Part I),* 47 N.Y.U. L. Rev. 407, 412 (1972) (bankruptcy "deals with an existing condition" and does not establish claims).

Because "[p]roperty interests are created and defined by state law," state law, not bankruptcy law, determines the interests of creditors in a bankruptcy estate. *Butner,* 440 U.S. at 54-55. Declaring "the basic federal rule" in bankruptcy to be "that state law governs," *id.* at 57, the Court observed in *Butner* that Congress has not redefined the rights of creditors in the bankruptcy laws but has "generally left the determination of property rights in the assets of a bankrupt's estate to state law," *id.* at 54-55. "Unless some federal interest requires a different result," the Court continued, "there is no reason why such interests should be analyzed differently simply because an interested party is in a bankruptcy proceeding." *Id.*; *see also In re Iowa R.R.,* 840 F.2d 535, 536-37, 539 (7th Cir. 1988) ("state law is the usual source of creditors' rights in bankruptcy cases," and "the bankruptcy court must implement rather than alter them").

Although *Butner* was decided under the former Bankruptcy Act, the Court has adhered to this fundamental view of bankruptcy under the Code. Citing *Butner*, the Court has repeatedly said that the rights of creditors in

the assets of a bankruptcy estate are determined by state law "[i]n the absence of a controlling federal rule," *Nobelman v. American Savings Bank,* 508 U.S. 324, 329 (1993), or "any controlling federal law," *Barnhill v. Johnson,* 503 U.S. 393, 398 (1992); *see also Grogan v. Garner,* 498 U.S. 279, 283 (1991). Unless a federal purpose to displace state law is "'clear and manifest,'" the Court declared recently, "the Bankruptcy Code will be construed to adopt, rather than displace, pre-existing state law." *BFP v. Resolution Trust Corp.,* 511 U.S. 531, 544-45 (1994) (quoting *English v. General Elec. Co.,* 496 U.S. 72, 79 (1990)).

The Trustee, however, disputes the application of state law in this case. Citing *Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156 (1946), he argues that "the allowance" of a claim under section 502 of the Code is "a question of federal law to which federal burdens of persuasion should apply." (Pet. Br. at 24).

The Trustee misinterprets *Vanston*. The statements in the opinion suggesting that the "allowance" of claims is a federal matter were made more than 40 years before the Code was enacted, and they must be taken in historical context. Under the Bankruptcy Act, "allowance" and "proof" of claims were distinct concepts. 3A *Collier on Bankruptcy* ¶ 63.05 at 1775-76 (James W. Moore, ed., 14th ed. 1975). Even claims found to exist and deemed proved might still be "disallowed" in whole or in part on an equitable basis. 3 *Collier on Bankruptcy* ¶ 57.14 at 228-33 (James W. Moore, ed., 14th ed. 1977). The equivalent of this pre-Code power is what the Code today terms "equitable subordination." *See* 11 U.S.C. § 510(c)(1);

United States v. Noland, 517 U.S. 535, 538 (1996); *In re Madeline Marie Nursing Homes*, 694 F.2d 433, 437 (6th Cir. 1982).

The courts of appeals have accordingly interpreted the broad language in *Vanston* and in *Pepper v. Litton*, 308 U.S. 295 (1939), to "establish a rule only for the distribution of assets." *Fahs v. Martin*, 224 F.2d 387, 394 (5th Cir. 1955). *Vanston* has "'never been applied . . . to oust state law in the original determination of the existence and amount of liability.'" *In re Highland Superstores, Inc.*, 154 F.3d 573, 578 (6th Cir. 1998) (quoting *In re Madeline Marie Nursing Homes*, 694 F.2d at 437). Indeed, *Vanston* itself explicitly states that "[w]hat claims of creditors are valid and subsisting obligations . . . is to be determined by reference to state law." *Vanston*, 329 U.S. at 161.

This case concerns the validity of a claim, not the distribution of a bankruptcy estate's assets. The validity of a claim is a state law issue, and the rights that government tax creditors assert in bankruptcy proceedings depend on state law. *Vanston*, 329 U.S. at 161; *see also Butner*, 440 U.S. at 55.

B. Burdens Of Proof Are Substantive Law And One Of A Creditor's Non-Bankruptcy Rights.

State law for this purpose includes the burden of proof that applies to a creditor's claim. Burdens of proof are substantive law. The burden of proof under tax law is therefore the government's substantive right.

The burden of proof peculiar to tax law is not just a procedural nicety. The Court has long held that burdens

of proof are substantive law. *See, e.g., American Dredging Co. v. Miller*, 510 U.S. 443, 454 (1994); *Dick v. New York Life Ins. Co.*, 359 U.S. 437, 446 (1959); *Palmer v. Hoffman*, 318 U.S. 109, 117 (1943); *Cities Service Oil Co. v. Dunlap*, 308 U.S. 208, 212 (1939); *see also In re Landbank Equity Corp.*, 973 F.2d 265, 270 (4th Cir. 1992); 1 Wigmore, *Evidence* § 5 at 358 (Tillers rev. 1983) ("burdens of proof and those evidentiary rules thought to affect burdens proof" are "most often treated as substantive"). A party's burden of proof "inhere[s] in his cause of action." *Garrett*, 317 U.S. at 249. It "is part of the very substance of his claim and cannot be considered a mere incident of procedure." *Id.*; *see also Cities Service*, 308 U.S. at 212 (stating that the burden of proof relates to a "substantial right," one on which a party "may confidently rely").

In his brief, the Trustee offers no serious argument that burdens of proof are not substantive law. Instead, he attacks the proposition indirectly, asserting that "bankruptcy courts are not bound under *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938)" and so implying that burdens of proof are only substantive when *Erie* is involved. (Pet. Br. at 22).

The Trustee is mistaken. Although burdens of proof are substantive for purposes of *Erie*, they are not, as the Trustee suggests, substantive because of *Erie*. Burdens of proof are substantive law because so often they turn out to be critical: "In all kinds of litigation it is plain that where the burden of proof lies may be decisive of the outcome." *Speiser v. Randall*, 357 U.S. 513, 525 (1958); *see also American Dredging*, 510 U.S. at 454 (burdens of

proof "bear upon the substantive right to recover"). The critical nature of the burden of proof is what makes it "part of the very substance" of a party's claim. *Garrett*, 317 U.S. at 249; *see also* 9 Charles Alan Wright & Arthur R. Miller, *Federal Practice & Procedure* § 2408 at 555 (1995) (burdens are a "matter of substance" because they are "associated closely with substantive rights").

The Court has never confined its view that burdens of proof are substantive to cases involving *Erie* questions, making burdens of proof substantive for *Erie* purposes but procedural for others. In *Garrett*, for example, the Court held that because burdens of proof are substantive law, the burden of proof on a federal claim applies when the claim is brought in state court. *Garrett*, 317 U.S. at 249; *see also Central V. Ry. v. White*, 238 U.S. 507, 511-12 (1915) (same). Recently, the Court again declared—without any sort of *Erie* qualification—that "the assignment of the burden of proof is a rule of substantive law." *Director v. Greenwich Collieries*, 512 U.S. 267, 271 (1994).

As the Seventh Circuit correctly noted, "the general pattern of American tax law" is to place the burden on the taxpayer to disprove his liability. (P.A. A-10). "[T]he usual procedure for the recovery of debts is reversed in the field of taxation. Payment precedes defense, and the burden of proof, normally on the claimant, is shifted to the taxpayer." *Bull v. United States*, 295 U.S. 247, 260 (1935); *see also United States v. Janis*, 428 U.S. 433, 441 (1976) (calling this "the usual rule with respect to the burden of proof in tax cases"); *Helvering v. Taylor*, 293 U.S. 507, 515 (1935). Both federal tax law, *see* Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 Hastings L.J. 239, 257 (1988), and state tax law, *see* Amicus Br. of State of New Mexico, et al., in Support of Cert. Pet. at 6 and n.3, typically allocate the burden of proof to the taxpayer.[5]

More than other burdens of proof, the tax law burden of proof "inheres" in the government's tax claim because of the claim's nature and its importance. *Garrett*, 317 U.S. at 249; *see Delaney v. Comm'r*, 99 F.3d 20, 23 (1st Cir. 1996) (tax law burden of proof is "more deeply rooted than the conventional regimen that places the burden of proof on the moving party"). The burden of proof directly advances the government's vital interest in securing revenue essential for government operations. Taxes are "the life-blood of government, and their prompt and certain availability an imperious need." *Bull*, 295 U.S. at 259; *see also United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 734 (1979). As a consequence, the government must resort to "more drastic means of collection" than other creditors, including a burden-shifting scheme under which the taxpayer must prove the government's assessment wrong. *Bull*, 295 U.S. at 259-60.

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[5] The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, altered federal tax law to place the burden of proof on the Internal Revenue Service. *See* 26 U.S.C. § 7491(a). That section, however, requires that several prerequisites be met before the burden shifts from the taxpayer to the I.R.S. *Id.* Because of these prerequisites, the extent to which section 7491(a) has any practical impact has been questioned. *See* Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules*, 84 Iowa L. Rev. 413 (1999).

The tax law burden of proof also stems from a recognition that state and federal tax systems depend on voluntary compliance by taxpayers rather than government enforcement. *See United States v. Bisceglia*, 420 U.S. 141, 144 (1975); *United States v. Generes*, 405 U.S. 93, 104 (1972). Under state and federal law, taxpayers are obligated to perform their own assessment and "disclose honestly all information relevant to tax liability." *Bisceglia*, 420 U.S. at 144. This obligation includes maintaining records that will enable taxpayers to make that disclosure. *See Spies v. United States*, 317 U.S. 492, 495 (1943) (a self-assessment system functions only when taxpayers "keep and render true accounts"). Taxpayers bear the burden of proof because they are more likely than the government to have information about their liabilities. *United States v. Rexach*, 482 F.2d 10, 16 (1st Cir. 1973).

The burden of proof under tax law, in short, is no "mere incident of procedure," *Garrett*, 317 U.S. at 249, but is an integral part of tax law, as much the government's right as the right to levy the tax itself. The state law burden of proof therefore applies in bankruptcy unless the Trustee shows "some federal interest" in displacing state law in tax cases, *Butner*, 440 U.S. at 55, an interest "clear and manifest" from federal law, *BFP*, 511 U.S. at 544; *cf. Grogan*, 498 U.S. at 283 (standard of proof governing "[t]he validity of a creditor's claim," as opposed to its dischargeability, is "determined by rules of state law").

C. No Federal Interest Displaces The State Law Burden Of Proof For Tax Claims.

The Trustee has shown no such federal interest. The Bankruptcy Code and the Rules of Bankruptcy Procedure say nothing about burdens of proof in claims objection proceedings, and, despite what the Trustee claims, there is no general bankruptcy policy of "equality of treatment of creditors" (Pet. Br. at 27), particularly none concerning allowance of claims. Far from displacing state law, federal bankruptcy policy and federal policy toward state tax administration weigh heavily in favor of employing the state law burden of proof.

1. The Bankruptcy Code And Rules Establish No Burdens Of Proof For The Allowance Of Claims.

Although the obvious source of a "federal interest" displacing state law would be federal bankruptcy law itself, bankruptcy law does not provide one. Nothing in the Bankruptcy Code sets burdens of proof for any claims, let alone alters the state law burden of proof for tax claims. Section 502 of the Code provides for the proof and allowance of claims, 11 U.S.C. § 502, and section 505(a) allows the bankruptcy courts to "determine the amount or legality of any tax," 11 U.S.C. § 505(a). Neither provision, however, addresses burdens of proof. Nor does any other section of the Code. *See Landbank*, 973 F.2d at 270-71; *Final Report of the National Bankruptcy Review Commission* 3.2.5 (Oct. 20, 1997), *reprinted in* vol. G *Collier on Bankruptcy* app. pt. 44 at 44-810 (Lawrence P. King, ed., rev. 15th ed. 1999) ("*Final*

Report"). The Trustee admits as much in his brief. (Pet. Br. at 8, 15, 17).

This omission was intentional. Elsewhere in the Code, Congress explicitly addressed burdens of proof. *See* 11 U.S.C. § 362(g) (relief from automatic stay); 11 U.S.C. § 363(o) (adequate protection); 11 U.S.C. § 364(d)(2) (adequate protection); 11 U.S.C. § 547(g) (avoidability of preferential transfer); 11 U.S.C. § 1129(d) (confirmation of plan for purpose of avoiding taxes). Although Congress could have established a burden of proof for claims, as well, it did not do so, and the Senate and House Reports explain the omission: "The burden of proof on the issue of allowance is left to the Rules of Bankruptcy Procedure." S. Rep. No. 95-989, 95th Cong., 2nd Sess. 62, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848; H.R. Rep. No. 95-595, 95th Cong., 2nd Sess. 352, *reprinted in* 1978 U.S.C.C.A.N. 5973, 6308.

But the Bankruptcy Rules assign no burdens of proof for claims either, something the Trustee also admits. (Pet. Br. at 8). Like the Code, the Rules set certain burdens of proof. *See* Fed. R. Bankr. P. 4003(c) (objection to exemption); Fed. R. Bankr. P. 4005 (objection to discharge). For claims, though, Rule 3001(f) states only that a proof of claim is "prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f). The Rule "does not, in a technical sense, allocate [the] burden of proof" but "simply establishes that a proof of claim constitutes evidence." *In re Cobb*, 135 B.R. 640, 641 (Bankr. D. Neb. 1992); *see also Thinking Machines Corp. v. New Mexico Taxation & Revenue Dep't*, 211 B.R. 426, 428, 430 n.5 (D. Mass. 1997); *In re Ford*, 194 B.R. 583, 589 (S.D. Ohio 1995). If Congress considers that a deficiency, it has never sought to remedy it in the Code.[6]

With the Bankruptcy Code and Rules silent on the matter, there is no "controlling federal law," *Barnhill*, 503 U.S. at 398, or "controlling federal rule," *Nobelman*, 508 U.S. at 329, that displaces the state law burden of proof.

2. The Trustee Identifies No Other Federal Interest That Displaces The Tax Law Burden Of Proof.

Unable to come up with any "federal rule" or "law," the Trustee contends that giving tax creditors the "benefit" of a burden of proof that other creditors do not enjoy is contrary to bankruptcy's "fundamental goal" of "equality of treatment of creditors." (Pet. Br. at 27). This is especially so, he says, given that tax claims already receive priority in distribution. (*Id.*).

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[6] In 1997, the National Bankruptcy Review Commission in fact recommended that Congress amend the Bankruptcy Code "to clarify" that the tax law burden of proof is "equally applicable in bankruptcy court proceedings to determine tax liabilities under 11 U.S.C. §§ 502 and 505." *Final Report, supra*, at 44-806. The Commission's recommendation was consistent with the views of commentators who have advocated applying the non-bankruptcy burden in bankruptcy cases. *See, e.g.*, 15 *Collier on Bankruptcy* ¶¶ TX5.03[5], TX5.04[6] (Lawrence P. King, ed., rev. 15th ed. 1999); C. Richard McQueen & Jack F. Williams, *Tax Aspects of Bankruptcy Law and Practice* § 7:25 (3rd ed. 1997).

The Trustee is wrong for two reasons. First, he grossly overstates the extent to which the bankruptcy laws are designed to achieve "equal treatment." Bankruptcy does not serve as the great leveler, and no bankruptcy principle calls for formal equality among creditors in all things. *See* Frances R. Hill, *Toward A Theory of Bankruptcy Tax: A Statutory Coordination Approach*, 50 Tax Law. 103, 162 (1996) ("[I]t is far from clear that formal equality is a principle of fairness in disputes among creditors"). The policy to which the Trustee refers is one of "equality of *distribution* among all creditors." H.R. Rep. No. 95-595, *supra*, at 186, *reprinted in* 1978 U.S.C.C.A.N. 5973, 6147 (emphasis added); *see also Landbank*, 973 F.2d at 270. Once claims are allowed, in other words, "creditors of equal priority should receive pro rata shares of the debtor's property." *Begier v. I.R.S.*, 496 U.S. 53, 58 (1990).

As the Department has observed, however, this case does not concern what assets should be distributed to creditors with allowed claims. It concerns whether the Department's claim should have been allowed in the first place. In suggesting that a policy of "equality" underlies the process governing the allowance of claims, the Trustee confuses two different stages of a bankruptcy proceeding.[7] *See* Thomas H. Jackson, *Bankruptcy, Non-*

[7] Even the policy with respect to distribution is not one of perfect equality. It is a "general policy" subject to exceptions, including "the grant of priority to certain claims" and "the subordination of certain claims." H.R. Rep. No. 95-595, *supra*, at 186, *reprinted in* 1978 U.S.C.C.A.N. 5973, 6147. At the dis-

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Bankruptcy Entitlements, and the Creditors' Bargain, 91 Yale L.J. 857, 859 (1982) (the assertion that "equality" is an overriding bankruptcy policy does not deal, "even roughly, with the plain fact that all bankruptcy laws to date accord substantial respect to non-bankruptcy entitlements").

Second, in the allowance of claims all creditors—private creditors and the government—*are* treated equally under the Code in an important sense. Except where Congress has expressly chosen to change substantive rights, all parties come into bankruptcy with the same rights and entitlements they had outside of bankruptcy. *See Butner*, 440 U.S. at 54-55, 57. All creditors are treated identically because the position they held is neither improved nor worsened, and the strength of their claims is neither increased nor decreased. In asking the Court to disturb the state law rights of government creditors by adopting a less favorable burden of proof for tax claims, the Trustee is not seeking equal treatment for non-governmental creditors. He wants better treatment.

[7] (...continued)
tribution stage, the government has historically enjoyed a favored status and continues to do so under the Code: tax claims are priority claims, 11 U.S.C. § 507(a)(8), and are non-dischargeable, 11 U.S.C. § 523(a)(1). The "egalitarian appeal" of the Trustee's argument "overlooks the frequent disparate treatment of the government as tax-creditor found in the Bankruptcy Code regarding such matters as the priority and dischargeability of claims." 15 *Collier on Bankruptcy*, *supra*, ¶ TX5.03[5] at TX5-25.

The Seventh Circuit rightly saw the Trustee's appeal to "equality of treatment" for what it is: an argument for the intervention of equity in the allowance of claims. (P.A. A-9-10). No such equitable authority exists. Although the Trustee in his brief continues to play up the equitable powers of bankruptcy courts (Pet. Br. at 28 and n.11), the Bankruptcy Code "does not authorize free-wheeling consideration of every conceivable equity." *N.L.R.B. v. Bildisco & Bildisco,* 465 U.S. 513, 527 (1984). Rather, the equitable powers of bankruptcy courts can only be exercised under the Code itself. *Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 206 (1988).

No Code provision authorizes bankruptcy courts to discount or even discard the state law rights of an entire class of creditors on equitable grounds, allowing the claims of some creditors and not others because some creditors are perceived to be "most worthy." *In re Milwaukee Cheese Wisconsin, Inc.,* 112 F.3d 845, 848 (7th Cir. 1997). "Undefined considerations of equity," the Court declared in *Butner*, do not entitle bankruptcy courts to fashion "uniform federal rule[s]" that rob creditors of their rights under state law.[8] *Butner,* 440 U.S. at 56; *see also Noland,* 517 U.S. at 540-41; *In re Highland*

[8] In contending that tax creditors should be deprived of state law rights when other creditors are accorded theirs, the Trustee is in fact advocating, not equity, but inequity. *See Butner,* 440 U.S. at 56 (conferring new rights on some creditors and negating the rights of others "when bankruptcy intervenes" is an "inequity"); *Iowa R.R.,* 840 F.2d at 536 (equity means "the consistent application of legal rules," and "[w]hen one claimant gets treatment that is denied to others, they have been treated inequitably") (internal quotation omitted).

Superstores, 154 F.3d at 578-79; *In re Lapiana,* 909 F.2d 221, 224 (7th Cir. 1990) ("bankruptcy judges are not empowered to dissolve rights in the name of equity").

As for the advantages tax creditors have over other creditors, those are advantages the law gives them. The "benefit" tax creditors reap from their burden of proof (Pet. Br. at 27) is one state law confers. Tax claims receive priority in bankruptcy because Congress said so in the Code. 11 U.S.C. § 507(a)(8). In drafting the Code, Congress specifically sought to balance the competing interests of debtors, private creditors and tax creditors. *See* S. Rep. No. 95-989, *supra*, at 14, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5800; *Landbank,* 973 F.2d at 270. Congress knew how to address taxes and burdens of proof, and Congress could have displaced the state law burden of proof for tax claims in the Code. It chose not to. Bankruptcy courts may not second-guess that choice, disfavoring tax creditors on the ground that "Congress has given them too much." *Thinking Machines,* 211 B.R. at 431 n.7 (internal quotation omitted).

The Trustee also mistakenly suggests that the "policy reasons" for placing the burden of proof on the taxpayer would not be "disserved" by reversing the burden of proof in bankruptcy. He asserts that trustees and private creditors "often" have no better understanding of the debtor's affairs and no more access to information than the government. (Pet. Br. at 27 n.10).

In most cases, though, trustees and creditors do have information about the debtor. Private creditors, who often insist on financial information as a condition of doing business, are in fact more likely to have infor-

mation than the government, which deals with the debtor on a non-consensual basis. The Code and Rules also give trustees and creditors committees the means to acquire information, authorizing them to investigate the debtor's finances, *see* 11 U.S.C. § 704(4); 11 U.S.C. § 1103(c)(2); 11 U.S.C. § 1302(b)(1), and to "examine any entity" concerning "the liabilities and financial condition of the debtor," Fed. R. Bankr. P. 2004(a), (b). *See also* 15 *Collier on Bankruptcy, supra,* ¶ TX5.03[5] at TX5-25 n.57 (noting that arguments of the kind the Trustee makes for shifting the burden of proof to the government "overlook the trustee's rights to the relevant books and records").

Moreover, access to information is not the only "policy reason" underlying the tax law burden of proof. Tax law also assigns the burden of proof to taxpayers to provide an incentive to meet their record-keeping obligations in a tax system based on voluntary compliance and self-assessment. *Rexach,* 482 F.2d at 16. Removing the burden of proof from taxpayers would destroy that incentive. *Barrows v. I.R.S.,* 231 B.R. 446, 452 (D.N.H. 1998); *Thinking Machines,* 211 B.R. at 431. The risks from a scarcity of information would fall on the government, not the taxpayer, and a taxpayer who kept few or no tax records would be rewarded by escaping liability.[9] *Rexach,*

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[9] It is no answer to argue that under 11 U.S.C. § 727(a)(3) a debtor who fails to keep records may be denied a discharge. (Pet. Br. at 27 n.10). Records sufficient for bankruptcy proceedings will not necessarily be records sufficient for taxing authorities to prove their claims. Nor are the Code's record-keeping requirements as strict as the requirements of tax law.
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482 F.2d at 17 (placing the burden on the government would undermine record-keeping requirements, making the government's case "more difficult if not impossible to establish").

These considerations, however, go to choices about policy—whether assigning the burden of proof to the government in bankruptcy would be a more sensible practice. That is not the question here. Congress enacted the Code, and suggestions about the best way to operate the bankruptcy system should be addressed to Congress rather than the Court. *See Kawaauhau v. Geiger,* 523 U.S. 57, 64 (1998) (bankruptcy policy is for Congress, not the Court, to decide). The only question in this case is whether any clear and manifest federal interest requires bankruptcy courts faced with tax claims to alter the burden of proof applicable to those claims under state law. *See Butner,* 440 U.S. at 55.

The Trustee has proposed no such federal interest. It is not enough to say that other creditors do not have the same rights as tax creditors, when the rights of all

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[9] (...continued)
Under section 727(a)(3), a credible excuse for the loss of records will often ensure a discharge, *see, e.g., In re Pisano,* 105 B.R. 125, 127 (Bankr. S.D. Fla. 1989) (debtor's unrebutted testimony that moving company lost carton of records deemed sufficient), whereas the loss of records is rarely a defense to tax liability, *see Andrew Crispo Gallery, Inc. v. Comm'r,* 16 F.3d 1336, 1343 (2nd Cir. 1994). Some debtors (consumer debtors, for example) are not even expected to have much in the way of records and generally are not denied a discharge under section 727(a)(3). *See* 6 *Collier on Bankruptcy* ¶ 727.03[3][g] at 727-36 (Lawrence P. King, ed., rev. 15th ed. 1999).

creditors are a matter of state law. *Butner,* 440 U.S. at 54. No bankruptcy policy is thwarted simply because state law gives one creditor greater rights than another. *In re Anchorage Int'l Inn, Inc,,* 718 F.2d 1446, 1451 (9th Cir. 1983).

3. Federal Policies Support The Use Of The State Law Burden Of Proof In Bankruptcy.

Not only has the Trustee identified no federal interest supporting the result the advocates, but several federal policies militate against altering the burden of proof when a taxpayer files bankruptcy.

First, shifting the burden of proof contravenes bankruptcy's neutral stance toward non-bankruptcy rights and the "uniform treatment of property interests" it ensures. *Butner,* 440 U.S. at 44; *see also Patterson v. Shumate,* 504 U.S. 753, 764 (1992) (stating that "treatment of pension benefits" should not "vary based on the beneficiary's bankruptcy status"). For the most part, bankruptcy neither confers new rights nor takes away old ones. If the burden of proof changes when taxpayers file bankruptcy, however, taxing authorities will be denied one of their non-bankruptcy rights. Taxpayers, meanwhile, will obtain a right they do not have when their tax liabilities are decided in state court. No party should receive "'a windfall merely by reason of the happenstance of bankruptcy.'" *Butner,* 440 U.S. at 55 (quoting *Lewis v. Manufacturers Nat'l Bank,* 364 U.S. 603, 609 (1961)). Nor should the rights of parties in tax disputes turn on whether the disputes are litigated in bankruptcy court or state court. *Ford,* 194 B.R. at 589-90.

Second, the bankruptcy laws are meant to discourage taxpayers from forum-shopping and from using bankruptcy "as a means of improperly avoiding their tax debts." S. Rep. No. 95-989, *supra,* at 14, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5800. Congress specifically intended "to make tax considerations as nearly neutral as possible with regard to whether a taxpayer should file a case under chapter 11." 15 *Collier on Bankruptcy, supra,* ¶ TX5.04[6] at TX 5-46; *see Butner,* 440 U.S. at 55 (uniform treatment of property interests serves to "discourage forum shopping"). If taxpayers can shift the burden of proof to the government merely by filing bankruptcy, however, bankruptcy proceedings will provide taxpayers with their best chance of avoiding tax liabilities. Taxpayers will quickly learn that they are better off defending tax claims in bankruptcy court than in state court, giving them an incentive to file bankruptcy and "funnel[ling] people with tax problems into the bankruptcy courts." *Thinking Machines,* 211 B.R. at 431.

Third, shifting the burden of proof to the government in bankruptcy would be contrary to fundamental principles of federalism. The power to tax is not only an aspect of state sovereignty but "is basic to the power of the State to exist." *Arkansas v. Farm Credit Servs.,* 520 U.S. 821, 826 (1997). Because of the importance of tax laws to the states, *Fair Assessment in Real Estate Ass'n v. McNary,* 454 U.S. 100, 108 (1981), Congress and the Court "repeatedly have shown an aversion to federal interference with state tax administration." *National Private Truck Council v. Oklahoma Tax Comm'n,* 515 U.S. 582, 586 (1995). They have recognized that federal intervention in state tax matters risks throwing state tax administration

"'into disarray,'" allowing taxpayers to escape the requirements of state law. *Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 527 (1981) (quoting *Perez v. Ledesma*, 401 U.S. 82, 128 (1971) (Brennan, J., concurring in part and dissenting in part)).

If the burden falls on the government to prove tax liability, state tax administration could be disrupted, and states could find it necessary to rework their tax laws. Because taxpayers will be able to contest their tax liabilities in a forum where they are relieved of the obligation to produce evidence, potential tax delinquents will no longer have much reason to maintain records. To compensate, states could well be forced to impose greater reporting requirements on all taxpayers, burdening them and intruding more deeply into their lives. Rather than chance revenue shortfalls, states may have to create new and expensive mechanisms for the sole purpose of ferreting out information that taxpayers previously had to supply themselves or risk tax liability if they did not. In that event, the states' costs of collection will increase; their net tax revenues will decrease.

Given the "strong background presumption against interference with state taxation," *National Private Truck Council*, 515 U.S. at 590, the policy of treating property interests in and out of bankruptcy uniformly, and the Congressional concern that bankruptcy not become a haven for tax delinquents, Congress could not have meant for tax claims to be determined in bankruptcy using a burden of proof different from the burden of proof in state court.

III. THE TRUSTEE'S HISTORICAL APPROACH IS NO SUBSTITUTE FOR THE ANALYSIS *BUTNER* REQUIRES.

In his brief, the Trustee spends little time proposing a federal interest that warrants displacing the state law burden of proof. Although *Butner* describes the applicable analysis, the Trustee barely mentions the case. (*See* Pet. Br. at 26). Rather than confront *Butner* and make the showing that decision requires, the Trustee tries to sidestep the issue, embarking on a lengthy excursion into bankruptcy history designed to preempt *Butner* altogether. (Pet. Br. at 9-20).

The problem with the Trustee's historical argument—an argument he has never made before in this litigation—is that both its premises are false. The history of the bankruptcy laws provides no basis for inserting burdens of proof to fill gaps in the Code. And even if past practice could be used this way, the Trustee's version of bankruptcy history is incorrect.

A. Past Practice Under The Bankruptcy Act Is An Aid To Construction, Not A Way Of Filling Gaps In The Code.

Federal common law under the Bankruptcy Act does not mechanically supplement the Code in all matters where the Code is silent, as the Trustee seems to believe. It is simply an aid to construction when Code provisions are unclear. Because no Code section addresses burdens of proof for claims, there is no Code section to be construed here. The history of bankruptcy practice is beside the point.

Although the Court has often examined practices under the Act in cases arising under the Code, it has done so only in the course of considering what existing Code provisions mean. *See, e.g., Cohen v. De La Cruz,* 523 U.S. 213, 221-22 (1998) (noting that history of fraud exception under the Act "reinforces our reading of § 523(a)(2)(A)"); *Noland,* 517 U.S. at 539 (considering past equitable subordination practice in interpreting section 510(c)); *United Savings Ass'n v. Timbers of Inwood Forest Assoc., Ltd.,* 484 U.S. 365, 373 (1988) (considering former practice where legislative history indicated section 506(b) "merely codified pre-Code bankruptcy law"); *Kelly v. Robinson,* 479 U.S. 36, 44, 47, 50 (1986) (considering "the language of §§ 101 and 523 in light of the history of bankruptcy court deference to criminal judgments" because that history "informs our understanding of the language of the Code"); *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection,* 474 U.S. 494, 501 (1986) (reviewing history of abandonment power as an aid to interpreting section 554).

Past bankruptcy practice, in other words, has served as a tool of statutory interpretation. *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 244-45 (1989) (explaining that in *Kelly* and *Midlantic*, for example, the Court "looked to pre-Code practice for interpretive assistance" where statutory language, "at least to some degree, was open to interpretation"). When Code provisions are ambiguous or unclear, Congress is assumed to have been aware of accepted practices under the Act and to have drafted the Code with them in mind. *Kelly,* 479 U.S. at 47; *Midlantic,* 474 U.S. at 501. This is no more than an application of "the normal rule of statutory construction"

that "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic,* 474 U.S. at 501.

The Court has not said, however, that it will automatically import "established practice" under the Act to fill every gap in the Code when no question of statutory meaning is at stake. *See Ron Pair,* 489 U.S. at 244 (in determining that Congress intends no departure from pre-Code practice, the Court has not simply relied "on a pale presumption to that effect"). To the contrary, the Court has made clear that it will not "adopt a court-made rule to supplement federal statutory regulation that is comprehensive and detailed." *O'Melveny & Myers v. F.D.I.C.,* 512 U.S. 79, 85 (1994); *see also Atherton v. F.D.I.C.,* 519 U.S. 213, 218-19 (1997). Instead, "matters left unaddressed in such a scheme are presumably left subject to the disposition provided by state law." *O'Melveny,* 512 U.S. at 85.

Federal common law may displace state law to fill gaps in a federal statutory scheme, but it does so only in instances when there is "'a significant conflict between some federal policy or interest and the use of state law.'" *Atherton,* 519 U.S. at 218 (quoting *O'Melveny*, 512 U.S. at 87). Those instances are "'few and restricted.'" *O'Melveny,* 512 U.S. at 87 (quoting *Wheeldin v. Wheeler,* 373 U.S. 647, 651 (1963)). Where the Bankruptcy Code is concerned, the Court has said, the statutory scheme will generally be construed "to adopt, rather than displace, pre-existing state law." *BFP,* 511 U.S. at 545.

The Trustee has not identified a Code provision he wants the Court to construe. He admits there is none. (Pet. Br. at 7-8, 15). Without such a provision, *O'Melveny*,

Atherton and *BFP* demand a conflict with "some federal policy or interest" before state law can be discarded—bringing the analysis back to *Butner*. *See Iowa R.R.*, 840 F.2d at 540. What past practices were under the Bankruptcy Act is irrelevant.

B. There Was No Accepted Judicial Practice Under The Act Of Placing The Burden Of Proof On Tax Creditors.

Even if past bankruptcy practices were relevant here, the Trustee has his history wrong. The trend in bankruptcy legislation over the last century was to subject the government as creditor to the same *procedures* in bankruptcy as other creditors, not to disrupt the government's *substantive* rights. The courts, meanwhile, had no established practice in bankruptcy cases of placing the burden of proof on the government in tax claims.

Changes in the bankruptcy laws since the 1898 Act was enacted do not show a Congressional desire to alter the non-bankruptcy rights of government creditors. It is true that taxes were not treated as claims under the original version of the Act but were obligations the trustee had to seek out and pay unless the bankruptcy court issued a bar order. *See* 3 *Collier on Bankruptcy, sup*[illegible], ¶ 57.30 at 433. It is true, as well, that the Chandler Act brought government claims, tax and otherwise, under the Act, requiring that they be filed and proved in the same manner as other claims.[10] *Id.* at 433-44; *see* S. Rep. No. 1916, 75th

[10] "Proving" a claim under section 57a of the Act (and later under former Bankruptcy Rule 301(a)) had nothing to do with
(continued...)

Cong., 3rd Sess. 2, 5 (1938); *In re Berkshire Hardware Co.*, 39 F. Supp. 663, 667 (D. Mass. 1941).

But these were procedural requirements. The purpose of the Chandler Act was to subject government claims to "substantially the same formalities and time limitations as other provable debts." 3A *Collier on Bankruptcy, supra,* ¶ 63.26 at 1900. In matters of bankruptcy procedure, the Chandler Act ensured that a government tax claimant was "in no better position than any other claimant," *In re Ward,* 131 F. Supp. 387, 395 (D. Colo. 1955), and in this respect tax claims were indeed to be treated "no differently from other claims." (Pet. Br. at 11). Thus, in *New York v. Saper,* 336 U.S. 328, 337 (1949), which the Trustee cites, the Court held that government creditors had no more right to post-petition interest—a matter of bankruptcy law—than any other creditor. *Id.* at 337; *see also Nicholas v. United States,* 384 U.S. 678, 683 (1966) (disallowing post-petition interest on post-petition tax liabilities).

Nothing in the Bankruptcy Act or in the Chandler Act, however, purported to alter the substantive, non-bankruptcy rights of tax creditors—the rights on which their claims in bankruptcy were based. It was instead well established under the Act that state law, not bankruptcy

[10] (...continued)
burdens or standards of proof. It meant supplying a statement setting forth the claim, listing any payments made on it, and declaring that the debtor owed the balance. *See* 11 U.S.C. § 93a (repealed); *In re Two Rivers Woodenware,* 199 F. 877, 881 (7th Cir. 1912) (stating that "[s]ection 57a shows how a claim is to be 'proved.'").

law, governed the substantive rights of creditors. As the Court observed: "[w]hat claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed, in the absence of overruling federal law, is to be determined by reference to state law." *Vanston,* 329 U.S. at 161.

This rule, reiterated in *Butner* more than 50 years later, was consistently applied under the Act. *See, e.g., Security Mortgage Co. v. Powers,* 278 U.S. 149, 153 (1928) (validity of attorney's lien in bankruptcy "must be determined by Georgia law"); *Benedict v. Ratner,* 268 U.S. 353, 359 (1925) (rights of claimant in bankruptcy depended "primarily upon the law of New York"); *Bryant v. Swofford Bros. Dry Goods Co.,* 214 U.S. 279, 291 (1909) ("in bankruptcy the construction and validity" of a contract "must be determined by the local laws of the State"); *see also* 3A *Collier on Bankruptcy, supra,* ¶ 63.07 at 1806-07 (noting that "[t]his principle has always been recognized" under the Act).

Nor did the Act address burdens of proof for claims—something the Trustee concedes—let alone the burden of proof for tax claims. (Pet. Br. at 12). *Whitney v. Dresser,* 200 U.S. 532 (1906), established no burden of proof. The Court held only that a proof of claim was "*prima facie* evidence of its allegations in case it is objected to," adding that this was "not a question of the burden of proof in a technical sense—a burden which does not change whatever the state of the evidence—but simply whether the sworn proof is evidence at all." *Id.* at 534-35. Section 57a of the Bankruptcy Act, 11 U.S.C. § 93a (repealed), and later former Bankruptcy Rule 301(b), only codified this decision.

Against this backdrop, the majority of lower federal court decisions considering tax claims in bankruptcy in fact employed the burden of proof from state or federal substantive tax law.[11] That, not the application of some

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[11] *See, e.g., In re Fox,* 609 F.2d 178, 181 (5th Cir. 1980) (debtor had burden of proving right to state sales tax deductions); *In re Uneco, Inc.,* 532 F.2d 1204, 1207 (8th Cir. 1976) (trustee had burden of proving bad debt deduction); *Paschal v. Blieden,* 127 F.2d 398, 401 (8th Cir. 1942) (trustee had burden of proof to show assessment incorrect); *United States v. Knox-Powell-Stockton Co.,* 83 F.2d 423, 425 (9th Cir. 1936) (trustee had burden of proving monies received were not income); *In re Lang Body Co.,* 92 F.2d 338, 341 (6th Cir. 1937) (trustee had burden of proving taxes were arbitrary and had to meet non-bankruptcy standard of proof); *In re Canady,* 43 A.F.T.R.2d (RIA) 472 (N.D. Ga. 1978) (non-bankruptcy burden of proof applied to objection to tax claim); *In re Menefee,* 40 A.F.T.R.2d (RIA) 5006 (E.D. Mo. 1977) (debtor had burden of proof on I.R.S. counterclaim); *In re Certified Credit Corp.,* 329 F. Supp. 1402, 1403 (S.D. Ohio 1971) (trustee had burden of proving right to deductions); *In re Standard Milling Co.,* 324 F. Supp. 386, 390 (N.D. Tex. 1970) (trustee had burden of proving property tax valuation was excessive under state law); *In re Reeves,* 25 A.F.T.R.2d (RIA) 761 (D. Colo. 1970) (trustee had burden of proof in dispute over I.R.S. assessment); *In re Oxford Assoc.,* 209 F. Supp. 242, 244-45 (D.N.J. 1962) (trustee had burden of proof in tax dispute); *In re Ward,* 131 F. Supp. 387, 390 (D. Colo. 1955) (trustee bore burden of proof on objection to tax claim); *In re Petersilge,* 70 F. Supp. 95, 96-97 (N.D. Ohio 1946) (trustee had burden of proving objection to state sales tax assessment); *In re Garfield Bag & Stationery Co.,* 42 F. Supp. 708, 711 (S.D.N.Y 1941) (trustee had burden to prove deductions under municipal tax ordinance); *In re Lasky,* 38 F. Supp. 24, 30 (N.D. Ala. 1941) (trustee had burden of proving objection

(continued...)

universal "bankruptcy" burden of proof, appears to have been the established practice. At worst, taking all of the cases the parties have cited, the courts had no consistent practice. But there was certainly no practice of the kind the Trustee claims, one "so widely accepted" as to justify the conclusion that displacing state law burdens was the norm. *Kelly,* 479 U.S. at 46.

In the wake of all this, Congress addressed the burden of proof question in 1978 the same way it had in 1898. It said nothing. As the Department has discussed, and as the Trustee admits, the Bankruptcy Code and Rules contain no burdens of proof for claims.

The Trustee's historical dissertation, then, amounts to little more than this. The Bankruptcy Act created no burden of proof for tax claims, and neither did any of the amendments to the Act. Between 1898 and 1978, federal

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[11] (...continued)
to property tax assessments); *In re Trustees System Co.,* 30 F. Supp. 361, 363 (W.D. Ky. 1939) (debtor had burden of proof in contesting federal income taxes); *In re Mid America Co.,* 31 F. Supp. 601, 607 (S.D. Ill. 1939) (trustee had burden under state law of proving debtor's exemption from state employment taxes); *In re Bell,* 34 F.2d 677, 680 (W.D. Pa. 1929) (trustee had burden of proving right to federal tax deduction), *modified on other grounds sub nom. Jarvis v. Heiner,* 39 F.2d 361 (3rd Cir. 1930); *In re Glover-McConnell Co.,* 9 F.2d 683, 686 (N.D. Ga. 1925) (debtor bore burden of proving entitlement to tax exemption); *In re O'Neill,* 80-2 U.S. Tax Cas. (CCH) ¶ 9716 (Bankr. W.D. Va. 1980) (debtor and trustee had burden of proof in dispute over tax penalty); *In re Osborn,* 4 B.R. 431, 435 (W.D. Mo. 1979) (debtor had burden of disproving liability for federal responsible officer penalty).

courts—to the extent they had a consistent practice at all—employed the burden of proof from substantive tax law in deciding the validity of tax claims. When the Code came into being in 1978, it contained no burden of proof for tax claims, and it still contains none. Neither do the Rules. That is not much of a basis for believing that Congress expects the Court to fashion a special, federal common law burden of proof for tax cases.

The Trustee's historical argument is a clever attempt, not only to avoid *Butner*, but to make it appear that the Department wants special treatment, a dispensation from long-standing rules of bankruptcy. Not so. The long-standing bankruptcy rule is that state law governs the rights of creditors, public and private, except where a federal interest demands otherwise. *Butner,* 440 U.S. at 54-55. In seeking to jettison the state law burden of proof that ordinarily applies to tax claims, the Trustee is the one asking for a special dispensation. To get it, though, the Trustee had to show a clear federal interest compelling that result. *Id.* He has not made that showing.

CONCLUSION

The decision of the United States Court of Appeals for the Seventh Circuit should be affirmed.

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In The

Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee
For the Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS,
DEPARTMENT OF REVENUE,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

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I.

CONGRESS IS CONSTITUTIONALLY EMPOWERED TO DETERMINE THE LAWS GOVERNING BANKRUPTCY PROCEEDINGS, AND BY DECLINING TO DEPART FROM PRE-CODE PRACTICES, CONGRESS IS DEEMED TO HAVE EXERCISED THAT POWER IN ASSIGNING THE BURDEN OF PERSUASION TO ALL CLAIMANTS, INCLUDING TAXING AUTHORITIES, IN CLAIM OBJECTION PROCEEDINGS.

The Constitution grants to Congress the authority to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const., Art. I, § 8, cl. 4. Congress is thus constitutionally empowered to determine the applicable law in all aspects of bankruptcy proceedings. *See International Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929) ("The power of Congress to establish uniform laws on the subject of bankruptcies throughout the United States is unrestricted and paramount."); *see also Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589 (1935) ("Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the states, it is not prohibited from impairing the obligations of contracts."); *Manhattan Properties, Inc. v. Irving Trust Co.*, 291 U.S. 320, 332 (1934) ("The issue [of bankruptcy claimant's right to recover on a claim for future rent] is not one of power, for plainly Congress may permit such claims or exclude them. The sole inquiry is the intent of the act."); *Butner v. United States*, 440 U.S. 48, 54 (1979) ("The constitutional authority of Congress to establish 'uniform Laws on the subject of Bankruptcies throughout the United States' would clearly encompass a federal statute defining the mortgagee's interest in the rents and profits earned by property in a bankrupt estate.").

Congress possesses a constitutional grant of power to alter creditors' rights arising outside of bankruptcy when those rights are made part of the bankruptcy process.

Indeed, the very notion of bankruptcy relief entails modification of state-created rights in one fashion or another, the most obvious example being discharge, in which such rights are erased in their entirety. *See Wright v. Union Central Life Ins. Co.*, 304 U.S. 502, 517 (1938) ("If the argument is that Congress has no power to alter property rights, because the regulation of rights in property is a matter reserved to the States, it is futile. Bankruptcy proceedings constantly modify and affect the property rights established by state law.").

It being undisputed that Congress has the power to determine how the burden of persuasion is to be allocated in bankruptcy proceedings, the question presented here is whether Congress has done so. The Bankruptcy Act, like the current Bankruptcy Code, was silent on the issue of allocation of burden of persuasion in claim objection proceedings. By not altering the general judicial practice under the Bankruptcy Act of allocating to all claimants (including taxing authorities) the burden of persuasion on their claims, however, Congress is deemed to have carried forward that practice under the Code. Congress, which is presumed to have known of the prior practice and took no action to change it, is assumed to have intended that the prior practice continue. *See Miles v. Apex Marine Corp.*, 498 U.S. 19, 32 (1990) ("When Congress passed the Jones Act, the *Vreeland* gloss on FELA, and the hoary tradition behind it, were well established. Incorporating FELA unaltered into the Jones Act, Congress must have intended to incorporate the pecuniary limitation on damages as well."); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 208 (1983) ("this interpretation of § 542 in the reorganization context is consistent with judicial precedent predating the Bankruptcy Code. . . . Nothing in the legislative history evinces a congressional intent to depart from that practice. . . . "); *Flood v. Kuhn*, 407 U.S. 258, 283-84 (1972) (declining to overturn longstanding judicial interpretation of statute where Congress, "by its positive inaction, has allowed those decisions to stand"); *Cannon v. University of Chicago*, 441 U.S. 677, 696-98 (1979) (implied private right of action

existed under Title IX; where Congress repeatedly referred to Title VI and its modes of enforcement in the course of enacting Title IX, it can be presumed that Congress was aware of numerous federal court decisions prior to Title IX's enactment which held that an implied private right of action existed under Title VI).

The Department and the *amici curiae* dispute that the predominant pre-Code practice allocated the burden of persuasion to taxing authorities. They contend that "the majority of lower federal court decisions considering tax claims in bankruptcy in fact employed the burden of proof from state or federal substantive tax law" (Dept. Br. 39), *i.e.*, allocated the burden of persuasion to the objector. In fact, many of the cases cited in support of this proposition – none of which purports to state the "majority rule" – appear to address not the burden of persuasion, but the burden of the objecting party to come forward with evidence sufficient to rebut the taxing authority's *prima facie* case.[1] Other cases cited by the Department and *amici* are

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[1] *See United States v. Knox-Powell-Stockton Co.*, 83 F.2d 423, 425 (9th Cir. 1936) ("The burden is upon the taxpayer to show what part, if any, of the moneys received was not income. Having failed to do so, the prima facie showing of the assessment is not overcome, and the tax must be sustained."); *In re Trustees Sys. Co.*, 30 F. Supp. 361, 365 (W.D. Ky. 1939) ("The question raised is whether the debtor-plaintiff's evidence is sufficient to rebut the presumptions against it. Full and conclusive proof is not required but it should be at least sufficient to render the existence of the negative probable in order to overcome the presumptions. Giving due weight, credit and value to the aggregate evidence, I am of the opinion it sufficiently meets the defendant's prima facie case to shift the burden to it to prove that the additional credits were in fact income."); *In re O'Neill*, 80-2 U.S. Tax Cas. (CCH) ¶ 9716, at 85,346 (Bankr. W.D. Va. 1980) ("Procedurally, there is a presumption the assessment of tax by Internal Revenue Service is accurate. This presumption transfers to the taxpayer the burden of going forward with evidence.") (citations omitted); *In*

distinguishable by their factual and procedural contexts.[2] Furthermore, the position of the Department and *amici* cannot be reconciled with the summary of case law in a late pre-Code version of *Collier on Bankruptcy* that "[a]s in the case of other types of claims, a filed proof of a tax claim in proper form establishes a *prima facie* case for the allowance of the claim. The burden of proof is on the claimant, but the burden of going forward and introducing evidence to rebut the *prima facie* case is on the objecting party." 3A J. Moore & L. King, *Collier on Bankruptcy* ¶ 64.409 at 2244-45 (14th ed. 1975).[3] Other pre-Code

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re Ward, 131 F. Supp. 387, 394 (D. Colo. 1955) ("The government offered no witnesses; it depended entirely and alone upon its assessment and the presumption arising therefrom. . . . All of the testimony adduced by the Trustee considered, the credibility of the witnesses given the weight and effect above stated, and the dependence of the government upon its presumption alone, leads to no other conclusion than that the Trustee has fully sustained the burden imposed upon him."); *In re Garfield Bag & Stationery Co.*, 42 F. Supp. 708, 711 (S.D.N.Y. 1941) ("The Trustee not having rebutted the prima facie evidence of the validity of the City's proof of claim, the Referee was in error in not allowing the claim."); *In re Osborn*, 4 B.R. 431, 435 (W.D. Mo. 1979) ("The applicable law, under these circumstances, is to the effect that the certified assessment is entitled to the presumption of correctness and the presumption prevails when no contradictory evidence is adduced.").

[2] *See In re Canady*, 43 A.F.T.R.2d ¶ 79-360, at 79-472 (N.D. Ga. 1978) (debtor brought adversary proceeding to challenge post-petition tax claim); *In re Menefee*, 40 A.F.T.R.2d ¶ 77-5002, at 77-5013 & n.19 (E.D. Mo. 1977) (holding that upon showing by government that taxpayer committed fraud, taxpayer has burden to set aside re-determination of taxes by government); *In re Glover-McConnell Co.*, 9 F.2d 683, 685-86 (N.D. Ga. 1925) (holding that debtor had burden of persuasion on affirmative defense of statute of limitations).

[3] The Court has previously recognized *Collier* as providing an authoritative statement of pre-Code practice. *See Kelly v. Robinson*, 479 U.S. 36, 45-46 (1986) (citing *Collier* regarding scope of discharge).

commentators agreed with *Collier*. *See* 2 H. Remington, *A Treatise on the Bankruptcy Law of the United States* § 1046 at 503 (rev. ed. 1956) ("Government tax claims have sometimes been regarded as on the sacrosanct side, though there is no justification for this. Such a claim is simply an ordinary claim. It is true that tax statutes often place a burden of proof on the taxpayer which would rest on the opposite party in ordinary litigation, but this is a peculiarity of tax law, not of bankruptcy law.").

In many contexts, Congress altered existing bankruptcy practice by incorporating specific provisions in the Code, *see United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 240 (1989), but this is not one of those instances. While Congress inserted certain tax-specific provisions into the Code, nothing in the Code or its legislative history indicates congressional intent to alter general pre-Code practice by creating a special exemption relieving taxing authorities of the burden of persuasion in claim objection proceedings.

II.

IF CONGRESS IS NOT DEEMED TO HAVE ESTABLISHED A RULE FOR ALLOCATING THE BURDEN OF PERSUASION, THEN THE DUTY TO DO SO DEVOLVES UPON THE COURT.

In the absence of specification by Congress, the task of choosing the source of the law governing a particular aspect of a federal statutory scheme becomes a task for the courts:

> Constitutionalism requires recognition of power in the federal courts to declare, as a matter of common law or "judicial legislation," rules which may be necessary to fill in interstitially or otherwise effectuate the statutory patterns enacted in the large by Congress. In other words, it must mean recognition of federal judicial competence

> to declare the governing law in an area comprising issues substantially related to an established program of government operation.
>
> . . .
>
> Where Congress has specifically made its choice – either by adoption of state law or by specifying a substantive rule for decisions – that choice of course governs without more. Where no such direction is provided, and yet the matter at issue is substantially related to a going national program, the selection of the source of governing rule devolves upon the courts. The problem then is identifying the criteria for choice.

P. Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. Pa. L. Rev. 797, 800, 811 (1957) ("Mishkin"). *See United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 593 (1973) (citing Mishkin and noting that "the inevitable incompleteness presented by all legislation means that interstitial federal lawmaking is a basic responsibility of the federal courts"). *See also Boyle v. United Tech. Corp.*, 487 U.S. 500, 504 (1988) ("But we have held that a few areas, involving 'uniquely federal interests' . . . are so committed by the Constitution and laws of the United States to federal control that state law is preempted and replaced, where necessary, by federal law of a content prescribed (absent explicit statutory directive) by the courts – so-called 'federal common law'.") (citations omitted).

Because of Congress's constitutionally conferred power to establish the laws governing all aspects of bankruptcy, the determination of which party bears the burden of persuasion in claim objection proceedings is a matter of legislative prerogative. *See Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451 (1937) ("Congress, in determining what . . . an equitable distribution demands, is free to establish standards of provability and measures of allowance regardless of the claimant's ability to maintain an action in a court or the measure of his recovery in such

an action if maintainable."). When Congress fails to act, it becomes a matter of judicial prerogative, with the courts taking into account the same policy considerations as would Congress. In *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), the Court discussed the framework for choosing a rule of decision in the absence of a Congressional choice:

> Controversies directly affecting the operations of federal programs, although governed by federal law, do not inevitably require resort to uniform federal rules. Whether to adopt state law or to fashion a nationwide federal rule is a matter of judicial policy "dependent upon a variety of considerations always relevant to the nature of the specific governmental interests and to the effects upon them of applying state law."
>
> Undoubtedly, federal programs that "by their nature are and must be uniform in character throughout the Nation" necessitate formulation of controlling federal rules. Conversely, when there is little need for a nationally uniform body of law, state law may be incorporated as the federal rule of decision. Apart from considerations of uniformity, we must also determine whether application of state law would frustrate specific objectives of the federal programs. If so, we must fashion special rules solicitous of those federal interests.

440 U.S. at 727-28 (citations omitted). *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 162 (1946) (In choosing to apply a uniform federal rule denying interest on interest on creditor claims – rather than choose between two arguably applicable state law rules – the Court noted that, the issue was to be determined on the basis of which rule was better "compatible with the policy of the Bankruptcy Act.").[4] *See also* V. Countryman, *The Use*

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[4] The Department and *amici* argue that the Trustee misinterprets *Vanston* because the Trustee does not take into

of State Law in Bankruptcy Cases (Part I), 47 N.Y.U. L. Rev. 407, 428-30 (1972) ("Countryman"). Thus, in the absence of congressional choice, it is the Court's prerogative to fashion the appropriate rule governing the allocation of the burden of persuasion in claim objection proceedings.

The Department argues that "[f]ederal common law may displace state law to fill gaps in a federal statutory scheme, but it does so only in instances where there is 'a significant conflict between some federal policy or interest and the use of state law.' *Atherton*, 519 U.S. at 218 (quoting *O'Melveny*, 512 U.S. at 87)." (Dept. Br. 35.) The term "displacement" as used by the federal courts in this context refers to the decision of the court whether to fashion a uniform federal rule or to adopt state law to provide a rule of decision in a federal legislative scheme:

> We refer here to the displacement of state law, although it is possible to analyze it as the displacement of federal-law reference to state law for the rule of decision. Some of our cases appear to regard the area in which a uniquely federal interest exists as being entirely governed by federal law, with federal law deigning to "borro[w]" . . . or "incorporat[e]" or "adopt" . . . state law except where a significant conflict with federal policy exists. We see nothing to be gained by expanding the theoretical scope of the federal preemption beyond its practical effect, and so adopt the more modest terminology. If the distinction between displacement of state law and displacement of federal law's incorporation of state law ever makes a practical difference, it at least does not do so in the present case.

Boyle v. United Tech. Corp., 487 U.S. 500, 507 n.3 (1988).

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account the pre-Code distinction between "proof" and "allowance" of claims. This distinction is irrelevant to the ruling in *Vanston*, namely, the enunciation of a federal principle that a bankruptcy creditor is not entitled to interest on interest. *See City of New York v. Saper*, 336 U.S. 328 (1949).

In the instant case, a uniform federal rule placing the burden of persuasion on all claimants is warranted because a " 'significant conflict' exists between an identifiable 'federal policy or interest and the [operation] of state law' . . . [and because] . . . the application of state law [burdens of persuasion] would 'frustrate specific objectives' of federal legislation." *Id.* at 507 (citations omitted). Fundamental federal interests and policy considerations militate in favor of the uniform allocation of the burden of persuasion to bankruptcy claimants, including taxing authorities. "[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another." *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941). As the Court stated in *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989), "the touchstone of each decision on allowance of interest in bankruptcy . . . has been a balance of equities between creditor and creditor or between creditors and the debtor." *Id.* at 248 (citation omitted). *See also Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 165 (1946) (same); *Katchen v. Landy*, 382 U.S. 323, 329 (1966) ("This power to allow or to disallow claims includes 'full power to inquire into the validity of any alleged debt or obligation of the bankrupt upon which a demand or a claim against the estate is based.' ") (citations omitted).

When a tax claim is litigated prior to bankruptcy, there are only two parties in interest, the taxing authority and the taxpayer. After the taxpayer files or is placed in bankruptcy, however, the primary parties in interest are the debtor's creditors, each of whom is vying for a share of the bankruptcy *res*. In this context, state law elements of any particular creditor's claim (whether arising in contract, tort or by operation of statute) are applicable to determine whether the creditor has a valid claim. Burdens of persuasion are different: burdens of persuasion do not define the elements of a claim, but go to the apportionment of risk

between litigants. A state law burden of persuasion governing the allocation of risk between a taxing authority and a taxpayer has no applicability in the bankruptcy context where the true parties in interest are no longer the taxing authority and the taxpayer but are, instead, the taxing authority and all the other creditors of the estate, and where the issue is the equitable division of estate assets among creditors.

The Bankruptcy Code's fundamental policies and objectives of equality of treatment of creditors are put at risk if one class of creditors is given the benefit of a favorable presumption that is unavailable to other creditors. Adopting nonbankruptcy burdens of persuasion (be they state or federal[5]) to relieve taxing authorities of the burden of persuasion to establish their claims improperly disrupts the balance of equities among creditors in bankruptcy estates. The only rule that serves the federal interests and does not frustrate the objectives of the Bankruptcy Code is a uniform federal rule placing the same burden of persuasion on all creditors, including taxing authorities, in claim objection proceedings.

With regard to the issue of equality of treatment, the Department responds that "the rights of all creditors are a matter of state law" and that "[n]o bankruptcy policy is thwarted simply because state law gives one creditor greater rights than another." (Dept. Br. 29-30.) The error with this analysis is that, under the Bankruptcy Code, state law rights of creditors are altered. The Department's assumption that state law governs all aspects of the claims allowance process in bankruptcy proceedings is clearly wrong, and whether a specific aspect of state-created rights – the burden of persuasion – should apply in claims allowance proceedings is precisely the question to be

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[5] One commentator has noted that with respect to federal tax claims, the "burden of persuasion differs somewhat in each of the three federal courts with jurisdiction in tax matters." E. Martin, *Burden of Persuasion: The Overlooked Defense To Tax Claims*, 21 Cal. Bankr. J. 117, 120 (1993).

decided here. *Accord United States v. Energy Resources Co.*, 495 U.S. 545, 549 (1990) (A "bankruptcy court has the authority to order the IRS to apply the payments to trust fund liabilities if the bankruptcy court determines that this designation is necessary to the success of a reorganization plan. . . . [B]ankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships.").

It is important to note that a decision to assign the burden of persuasion to the Department is by no means a general repudiation of the applicability of Illinois law to the substantive issue of whether the Department has a valid claim. While state law may generally govern the rights and liabilities of parties in claim objection proceedings, particular aspects of state law – as to which there are countervailing federal considerations – should not apply. *See United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 594-95 (1973); *Teamsters Pension Trust Fund v. Littlejohn*, 155 F.3d 206, 209 (3d Cir. 1998) (while federal courts have looked to state law to formulate rules to fill gaps in ERISA, "it is important that the federal courts . . . do not strictly adhere to a single state's law at the expense of . . . furthering the policies of ERISA"). Thus, while "in the absence of overruling federal law, [the validity of claims] is to be determined by reference to state law," *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161 (1946), it is left to the Court to determine how much and what aspects of state law apply. If portions of state law are inimical to or inconsistent with the purposes of the federal statutory scheme, those portions of state law should not be applied.

> [A] decision to apply state law as a matter of federal incorporation does not necessarily carry with it the obligation to adhere to the range and techniques which have been held to govern under *Erie*; there remains a freedom, after decision to incorporate local law, to control the extent and methods of that adoption which is not present when a determination has been made that

> state law will apply because the court has no competence to do otherwise.
>
> . . .
>
> Since the issue's outcome bears some relationship to a federal program, no rule may be applied which would not be wholly in accord with that program.

Mishkin at 804, 805-06. *See also Stellwagen v. Clum*, 245 U.S. 605, 613 (1918); *Local Loan Co. v. Hunt*, 292 U.S. 234, 243-44 (1934).

The Department argues in the alternative that federal common law does not "supplement the Code in all matters where the Code is silent." (Dept. Br. 33.) "It is simply an aid to construction when Code provisions are unclear." (*Id.*) The Department cites no authority for the proposition that "federal common law" may be employed only for the purpose of interpreting a particular Code provision. The Department's contention also ignores the nature of the task the Court is called upon to undertake, namely, to decide which law (be it state or federal) is better suited to address a particular matter left unaddressed by Congress in a federal statutory scheme. In any event, there is a specific Code section to be interpreted and illuminated here, 11 U.S.C. § 502, governing the allowance of claims in bankruptcy proceedings.

The Department and *amici* also make the policy argument that dire consequences will result if the Trustee's position is adopted. According to the Department and *amici*, adoption of the Trustee's position would lead to an intolerable situation, with tax delinquents lining up to file bankruptcy and placing the entire system of tax collection in disarray. The problem with this prediction is that, for a substantial portion of the country, the Trustee's position *is* the law, and has been for some time. In four circuits, covering fully half the states, the burden of persuasion

rests with the taxing authorities on objections to their claims in bankruptcy.[6]

None of the dire consequences predicted by the Department and *amici* has come to pass for obvious reasons. Bankruptcy is not a safe haven for tax delinquents. Taxpayers with inadequate records fare no better in bankruptcy court than in nonbankruptcy forums. Without adequate records, debtors are not able to rebut the *prima facie* evidence established by a taxing authority's proof of claim. Failure to maintain adequate records also may lead to the denial of an individual debtor's discharge, 11 U.S.C. § 727(a)(3), and may lead to the appointment of a trustee in a chapter 11 case or conversion to chapter 7. Furthermore, because a debtor's tax obligations are largely nondischargeable, the taxing authority can always pursue the debtor directly outside of bankruptcy. *See* 11 U.S.C. § 523(a)(1).

Contrary to the contention of the Department and *amici*, *Butner v. United States*, 440 U.S. 48 (1979), does not dictate a contrary result. In *Butner*, the Court declined to create a federal rule regarding a mortgagee's entitlement to rents where Congress had chosen not to exercise its constitutional power to do so. The Court stated that Congress had "generally left the determination of property rights in the assets of a bankrupt's estate to state law. . . . [and] [u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 54-55. By contrast, in the present case, fundamental federal interests and the specific objectives and goals of the bankruptcy process are frustrated unless all creditors, including taxing authorities, are required to shoulder the same burden of

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[6] *See In re Fidelity Holding Co.*, 837 F.2d 696, 698 (5th Cir. 1988); *In re Fullmer*, 962 F.2d 1463, 1466-67 (10th Cir. 1992); *In re Brown*, 82 F.3d 801, 805 (8th Cir. 1996); *In re Macfarlane*, 83 F.3d 1041, 1044-45 (9th Cir. 1996). *See also In re Arndt*, 201 B.R. 853, 857-58 (M.D. Fla. 1996).

persuasion in claim objection proceedings. *Cf. Associates Commercial Corp. v. Rash*, 520 U.S. 953, 964-65 (1997) (In order to "serve the interests of predictability and uniformity" and rather than incorporate standards from applicable state law, the Court fashioned a federal rule under 11 U.S.C. § 506(a) to determine "value" of collateral retained by the debtor because of the debtor's exercise of "cram down" rights under 11 U.S.C. § 1325(a)(5)(B).).

III.

NEITHER *ERIE* NOR THE RULES OF DECISION ACT REQUIRES APPLICATION OF STATE LAW BURDENS OF PERSUASION.

The contention of the *amici* that, in the absence of a directive from Congress, *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938), and the Rules of Decision Act, 28 U.S.C. § 1652, dictate the application of state law burdens of persuasion is wrong. The "great object" of *Erie* "was to secure in the federal courts, in diversity cases, the application of the same substantive law as would control if the suit were brought in the courts of the state where the federal court sits." *United States v. Standard Oil Co.*, 332 U.S. 301, 307 (1947). Objections to claims in bankruptcy proceedings are not litigated in federal court because of the happenstance of the citizenship of the litigants or because of pendent federal jurisdiction, but rather as part of a constitutionally mandated, comprehensive federal statutory framework. The instant case does not implicate considerations of the uniformity of result as to litigation of state law claims in state versus federal courts, and *Erie* has no application here. *See Levinson v. Deupree*, 345 U.S. 648, 651 (1953); *Fore Improvement Corp. v. Selig*, 278 F.2d 143, 147 (2d Cir. 1960) (Friendly, J., concurring). *See also* Countryman at 409-11.

The question presented in this case is whether a taxing authority should bear the burden of persuasion on an objection to the allowance of its proof of claim in a bankruptcy proceeding under section 502 of the Bankruptcy Code. Neither *Erie* nor the Rules of Decision Act has any

role to play in the exercise of legislative or judicial prerogative in the selection of law to govern the operation of, or adjudication of rights under, a federal statutory scheme. *DelCostello v. International Bhd. of Teamsters*, 462 U.S. 151, 159 n.13 (1983) ("[N]either *Erie* nor the Rules of Decision Act can now be taken as establishing a *mandatory* rule that we apply state law in federal interstices.") (emphasis in original; citations omitted); *United States v. Standard Oil*, 332 U.S. 301, 307 (1947) ("the Erie decision, which related only to the law to be applied in exercise of that [*i.e.*, diversity] jurisdiction, had no effect, and was intended to have none, to bring within the governance of state law matters exclusively federal, because made so by constitutional or valid congressional command"). As Professor Mishkin explains:

> *Erie* . . . is not controlling on problems implicated in the operation of a congressional program. From this aspect, *Erie*'s basic holding was a determination that the particular subject matter involved was beyond the law-making competence of the federal courts; that the area was one where state law governed of its own authority, and the mere grant of jurisdiction to adjudicate a case did not carry with it the power to declare an independent "general" rule displacing that authority. These propositions are inapposite to problems which bear substantial relation to an established federal operation. As to such questions, state law cannot govern of its own force; there must be competence in the federal judiciary to declare the governing law.

Mishkin at 799.

These principles apply to the federal scheme created by the bankruptcy statute. *See Prudence Realization Corp. v. Geist*, 316 U.S. 89, 95 (1942) ("Nothing decided in Erie Railroad Co. v. Tompkins, supra, requires a court of bankruptcy to apply such a local rule governing the liquidation of insolvent estates. The bankruptcy act prescribes its own criteria for distribution to creditors. In the interpretation

and application of federal statutes, federal not local law applies."); *Heiser v. Woodruff*, 327 U.S. 726, 732 (1946) ("For nothing decided in Erie R. Co. v. Tompkins, supra, requires a court of bankruptcy, in applying the statutes of the United States governing the liquidation of bankrupts' estates, to adopt local rules of law in determining what claims are provable, or to be allowed, or how the bankrupt's estate is to be distributed among claimants."); *Fore Improvement Corp. v. Selig*, 278 F.2d 143, 147 (2d Cir. 1960) (Friendly, J., concurring) ("Of course, Congress is not required to direct the federal courts to look to state law for the definition of state-created rights asserted in bankruptcy, as it is when federal jurisdiction rests solely on diversity of citizenship. The question is of intent, not of power."). *See also* Countryman at 411.

Furthermore, and again contrary to the arguments of *amici*, *Erie* can have no application here because there could not have been "an action upon the same claim by the same parties in a state court." *See Guaranty Trust Co. v. York*, 326 U.S. 99, 109 (1945). When a proof of claim is filed in a bankruptcy proceeding, allowance of that claim (though the claim is predicated on a state-created right) is determined only as part of the bankruptcy process. Bankruptcy transforms claims against a debtor into an equitable division of a *res* among the debtor's creditors. *Accord Sexton v. Dreyfus*, 219 U.S. 339, 345 (1911) ("At that moment the creditors acquire a right *in rem* against the assets."). Creditors in a bankruptcy proceeding are no longer asserting claims against the debtor, but rather against the assets of the debtor's estate. The dispute is no longer creditor versus debtor but, rather, the dispute is among all the creditors of the estate as they vie for a share of the available assets. The bankruptcy trustee's statutory obligation to object to claims, 11 U.S.C. § 704(5), and the statutory ability of a creditor, creditors' committee, or other "party in interest", 11 U.S.C. § 502(a), to object to a creditor's claim exist only in the context of bankruptcy

proceedings.[7] Accordingly, the linchpin of the *Erie* analysis – that the same result should obtain in federal court as in state court on the same claims between the same parties – is missing. The parties are different, the claims are different, the comparable state law forum is non-existent,[8] and the interests at stake are different.

The Department's argument that state law should be applied here because burdens of persuasion are "substantive" rather than "procedural" is predicated on a distinction with no meaning or applicability in the present context. The substantive/procedural distinction is relevant when a court is mandated to apply the substantive law of a jurisdiction other than its own. *See Garrett v. Moore-McCormack Co.*, 317 U.S. 239, 245, 249 (1942) (In adjudicating a Jones Act claim, a state court is required to apply the burden of proof specified in federal law. The state court in such a case is required to ensure that "all the substantial rights of the parties under controlling federal law would be protected."); *Dick v. New York Life Ins. Co.*, 359 U.S. 437, 446 (1959) (federal court sitting in diversity is required by *Erie* to apply substantive state law, including state law concerning burden of proof). However, the distinction is irrelevant in a case such as this where the determination of the governing law is constitutionally a matter of legislative prerogative, and, in the absence of congressional action, a matter of judicial prerogative.

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[7] A chapter 11 debtor similarly acts as a "debtor-in-possession" with fiduciary obligations to act in the best interests of creditors of its estate. *See* 11 U.S.C. §§ 1106, 1107(a).

[8] "In federal question cases with exclusive jurisdiction in federal court, such as bankruptcy . . . , the risk of forum shopping which is avoided by applying state law has no application, because *the case can only be litigated in federal court*. The value of national uniformity of approach need not be subordinated, therefore, to differences in state choice of law rules." *In re Lindsay*, 59 F.3d 942, 948 (9th Cir. 1995) (citations omitted; emphasis added).

The Department tacitly acknowledges this, but attempts to salvage the substantive/procedural distinction by arguing that the burden of persuasion should be treated as inherently substantive, and not merely substantive because of *Erie*: "Although burdens of proof are substantive for purposes of *Erie*, they are not, as the Trustee suggests, substantive because of *Erie*." (Dept. Br. 17.) But the substantive/procedural distinction is meaningless when divorced from a context such as *Erie* in which the court is mandated to apply the substantive law of another jurisdiction.

In the present context, for example, the distinction has no meaning because, whether a state law is characterized as substantive or procedural, it will be applied only if Congress (or the Court) sees fit to do so. The mere attaching of the "substantive" label to a state law will not save it from being overridden by supervening federal bankruptcy principles. Or, to put it another way, the "substantive" label is no guaranty that the state law will be selected for application in the bankruptcy context. Thus, in *Grogan v. Garner*, 498 U.S. 279 (1991), federal rather than state law was held to govern the "substantive" issue of the burden of proof applicable to the dischargeability of a state law claim against the debtor.[9] Similarly, although statutes of

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[9] The Council of State Governments argues that: "[C]ontrary to Petitioner's assertion, *Grogan* only confirms that under the Bankruptcy Code of 1978, as was the case pre-Code, the 'validity of a creditor's claim [in bankruptcy court] is determined by rules of state law.' 498 U.S. at 283 (citing *Vanston*, 329 U.S. at 161)." (Council Br. 12.) The Court's decision in *Vanston*, upon which *Grogan* relies, states that the determination of allowance of claims in a bankruptcy estate does not implicate *Erie*, but rather "bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 162-63 (1946).

limitations are deemed "substantive" for purposes of *Erie* analysis, *see Guaranty Trust Co. v. York*, 326 U.S. 99 (1945), state law statutes of limitations are displaced in bankruptcy proceedings. Dates set for the filing of proofs of claim – whether by Bankruptcy Rule in a chapter 7, 12 or 13 proceeding, or by the bankruptcy court in a Chapter 9 or 11 proceeding – trump state law statutes of limitations. Thus, a creditor possessing a claim for breach of written contract against a chapter 7 debtor who ordinarily would have several years to file suit under the applicable state statute of limitations, must file a proof of claim within the truncated period set forth in Bankruptcy Rule 3002(c).[10] *See also Fidelity Fin. Serv., Inc. v. Fink*, 522 U.S. 211, 220-21 (1998) (time period within which secured party must perfect security interest to prevent avoidance by trustee determined by federal, not state, law).[11]

The Bankruptcy Code is a comprehensive statutory framework setting forth the mechanisms whereby the

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[10] Rule 3002(c) provides that in cases under Chapters 7, 12, and 13 of the Code, proofs of claim must be filed within 90 days of the first date set for meetings of creditors under section 341 of the Code. Rule 3003(c)(3) provides that the bankruptcy court shall set a bar date in Chapter 11 cases. With limited exceptions, the failure to file a proof of claim by the applicable bar date results in the disallowance of the claim. 11 U.S.C. § 502(b)(9).

[11] The right to a jury trial – among the most fundamental of all rights, *Aetna Ins. Co. v. Kennedy*, 301 U.S. 389, 393 (1937) – is also lost by creditors who file proofs of claim in bankruptcy, not only with respect to their own claims, but on the estate's claims against them as well. *Langenkamp v. Culp*, 498 U.S. 42 (1990); *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989); *Katchen v. Landy*, 382 U.S. 323 (1966). As explained in *Granfinanciera*, the Court's holdings on this issue turned not on the ground that a bankruptcy court is a court of equity, but rather, on the bankruptcy court's having "actual or constructive possession" of the bankruptcy estate and its "power and obligation to consider objections by the trustee in deciding whether to allow claims against the estate." 492 U.S. at 57.

rights of competing creditors in a bankruptcy estate are adjudicated. A creditor who chooses to participate in this unique process by filing a proof of claim necessarily subjects itself to the rules applicable to that process. *Langenkamp v. Culp*, 498 U.S. 42, 44 (1990) ("by filing a claim against a bankruptcy estate the creditor triggers the process of 'allowance and disallowance of claims', thereby subjecting himself to the bankruptcy court's equitable power."). As a result, rights enjoyed by creditors outside the bankruptcy context may no longer apply once the creditor files a proof of claim. Sound federal policy mandates that in bankruptcy, all claimants, including state and federal taxing authorities, should bear the burden of persuasion to establish their claims.

CONCLUSION

For the reasons stated herein and in the Brief for Petitioner, petitioner respectfully requests that the judgment of the court of appeals be reversed.

Respectfully submitted,

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No. 99-387

In the Supreme Court of the United States

THOMAS E. RALEIGH, CHAPTER 7 TRUSTEE
FOR ESTATE OF WILLIAM J. STOECKER, PETITIONER

v.

STATE OF ILLINOIS DEPARTMENT OF REVENUE

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

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QUESTION PRESENTED

Whether the burden of proof for a tax claim, which rests upon the taxpayer as a matter of substantive law, is shifted to the government when that claim is litigated in the taxpayer's bankruptcy case.

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In the Supreme Court of the United States

No. 99-387

THOMAS E. RALEIGH, CHAPTER 7 TRUSTEE FOR ESTATE OF WILLIAM J. STOECKER, PETITIONER

v.

STATE OF ILLINOIS DEPARTMENT OF REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

INTEREST OF THE UNITED STATES

The Internal Revenue Service files more than 100,000 proofs of claim in bankruptcy cases each year seeking to recover several billion dollars of taxes. It has long been the general rule in litigation contesting tax liabilities that the taxpayer bears the burden of proof. The question presented in this case is whether that burden of proof is placed instead on the taxing authority merely because the tax case is litigated in bankruptcy court. That question is one of substantial recurring importance in the administration of the federal tax laws.

STATEMENT

1. William Stoecker was the president and sole director of Chandler Enterprises, Inc., an Illinois corporation. That corporation purchased an airplane from an out-of-state seller in 1988. Pet. App. B2. The State of Illinois imposes a use tax on Illinois residents "upon the privilege of using in this State tangible personal property" whether such property is purchased in Illinois or elsewhere. Ill. Rev. Stat. ch. 120, ¶ 439.3 (Smith-Hurd 1989). Retailers in Illinois, and foreign retailers with an adequate nexus to Illinois, are required to collect and pay over that tax to Illinois. *Ibid.* Any tax "not paid to a retailer * * * shall be paid to the Department [of Revenue] directly by any person using such property within [Illinois]." *Ibid.* A purchaser whose seller does not pay the use tax is thus to file a return with the Department of Revenue and pay the tax. *Id.* ¶ 439.10. In this case, however, neither Chandler Enterprises nor the out-of-state seller of the airplane filed an Illinois use tax return or paid the Illinois use tax. Pet. App. B2-B3.

2. In 1989, the creditors of Mr. Stoecker initiated involuntary bankruptcy proceedings against him under Chapter 11 of the Bankruptcy Code. The bankruptcy case was later converted to a liquidation proceeding under Chapter 7 of the Bankruptcy Code. Pet. App. C12. While the bankruptcy case was pending, the Illinois Department of Revenue issued a Notice of Tax Liability to Chandler Enterprises for the unpaid use tax on the airplane. The corporation had been involuntarily dissolved, however, and thus did not pay the use tax. *Id.* at B2-B3.

Under Illinois law, a corporate officer "who has the control, supervision or responsibility of filing returns

and making payment of the amount of any * * * tax * * * who wilfully fails to file the return or make the payment * * * shall be personally liable for a penalty equal to the total amount of tax unpaid by the [corporation]." 35 Ill. Comp. Stat. Ann. 735/3-7 (West 1999). Invoking that provision, the Illinois Department of Revenue issued a Notice of Penalty Liability asserting that Mr. Stoecker was personally liable for the unpaid taxes of the corporation. Pet. App. B2-B3, C20-C21. The State thereafter filed a proof of claim in the amount of $911,769 in Mr. Stoecker's bankruptcy case. *Id.* at C20 & n.12.

3. The bankruptcy court upheld the trustee's objection to the State's claim. Pet. App. C1-C81. Relying on *Franchise Tax Board of California* v. *MacFarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996), cert. denied, 520 U.S. 1115 (1997), the bankruptcy court concluded that the State had the burden of proof on its tax claim because "the ultimate burden of persuasion always remains with the claimant to prove entitlement to the claim." Pet. App. C5. The court held that the Department's notice of liability and proof of claim constituted "prima facie proof as to all elements of [the tax] liability" and that "[t]he burden then shifted to the Trustee to rebut the presumption created by" the notice. *Id.* at C73. The court stated, however, that the trustee had properly rebutted that presumption by "showing that the Debtor was not in control [of the corporation] and thus could not have voluntarily or willfully failed to pay the tax." *Ibid.* The court held that "[t]he ultimate burden of proof then shifted back" to the State to show that its claim should be allowed. *Ibid.* The court ruled against the State because it failed to "refute" the debtor's evidence "and to ultimately sustain its burden of proof * * * ." *Id.* at C74.

4. The district court affirmed. Pet. App. B1-B21. The court first held that it was barred by 28 U.S.C. 1341 from reviewing the State's determination that the corporation was liable for the use tax. Pet. App. B13-B16. That statute deprives the district courts of jurisdiction to enjoin or restrain the assessment or collection of state taxes when a plain, speedy, and adequate remedy may be had in the state courts. 28 U.S.C. 1341. The district court concluded that this statute barred it from reviewing the validity of the state tax assessment against the corporation. With respect to the State's claim against the debtor in his individual capacity, however, the court held that the State bore the burden of proof. Pet. App. B8. The court sustained the conclusion of the bankruptcy court that the State failed to meet that burden by showing that the debtor had control, supervision, or responsibility for paying the use tax liability of the corporation. *Id.* at B9-B12.

5. The court of appeals reversed. Pet. App. A1-A13. The court of appeals rejected the conclusion of the district court that 28 U.S.C. 1341 bars federal courts from reviewing the tax liability of the corporation in this bankruptcy case. On the merits, however, the court of appeals concluded that the state tax had been lawfully assessed upon the corporation. Pet. App. A7.

Having thus reached the question of the debtor's individual liability for that tax, the court of appeals stated that there was "no proof either that [the debtor] was responsible for" filing Chandler's tax returns or paying Chandler's taxes "or that he willfully evaded the payment of the use tax." Pet. App. A7. The court concluded, however, that "just as under the corresponding federal law of responsible-officer liability for unpaid taxes, 26 U.S.C. § 6672 * * * , Illinois shifts the burden of proof—both production and persuasion—to

the officer once a Notice of Penalty Liability is issued, * * * and the trustee has not carried it." Pet. App. A7. The court stated that, while the debtor "may have satisfied his burden of production by identifying" another individual as the "corporate financial officer, * * * he has not satisfied the burden of persuasion." *Id.* at A7-A8. Noting that the proper allocation of the burden of proof "is critical" to resolution of this case, the court of appeals held that the debtor was liable for the tax. *Id.* at A8.

The court of appeals rejected the trustee's argument that "equity" requires the burden of proof for tax claims to be placed on the government in bankruptcy cases. Pet. App. A9. The court stated that "[b]ankruptcy is not a 'free-for-all equity balancing act.'" *Ibid.* (quoting *In re Lapriano*, 909 F.2d 221, 223 (7th Cir. 1990)). Instead, "it is now well settled that although the origins, procedures, and many of the remedies of bankruptcy are indeed equitable, a bankruptcy judge has no authority to cut down the entitlements that creditors seek to enforce in bankruptcy, except * * * as provided by the Bankruptcy Code itself." Pet. App. A9. The court concluded that "[b]urden of proof is rightly classified as a part of the creditor's entitlement" that "is not shifted in bankruptcy." *Id.* at A10.

The court of appeals acknowledged that the decision of the Ninth Circuit in *Franchise Tax Board of California* v. *MacFarlane*, 83 F.3d at 1045, conflicts with the decision in this case. The court concluded, however, that the view adopted here and in *In re Landbank Equity Corp.*, 973 F.2d 265, 270 (4th Cir. 1992), is preferable because (Pet. App. A10):

> [i]t is supported by the general pattern of American tax law, in which "payment precedes defense, and

> the burden of proof, normally on the claimant, is shifted to the taxpayer," *Bull v. United States*, 295 U.S. 247, 260 (1935), and by the countless cases which hold that burden of proof is "substantive" for purposes of the Erie doctrine, e.g., *Director v. Greenwich Collieries*, 512 U.S. 267, 271 (1994); *American Dredging Co. v. Miller*, 510 U.S. 443, 454 (1994) * * * .

The court of appeals noted that, although Congress could have provided a different result for tax claims in bankruptcy cases, there is no indication that it sought to do so. The court observed that, while close attention was paid to issues of burden of proof in several provisions of the Bankruptcy Code, the Code is silent on the burden of proof in tax cases. Pet. App. A11. The court noted, moreover, that a rule shifting the burden of proof to the government on tax claims in bankruptcy cases would create an undesirable incentive for taxpayers to declare bankruptcy. *Ibid.* Concluding that the burden of proof rests on the taxpayer in this case—just as it would if the tax claim had been adjudicated outside of bankruptcy court—the court of appeals held that "the state has a valid claim * * * and that the decision of the district court must therefore be reversed." *Id.* at A12.

SUMMARY OF ARGUMENT

The proper allocation of the burden of proof is a substantive rule governed by the law that creates the underlying claim. The State of Illinois follows the traditional rule that allocates the burden of proof on tax claims to the taxpayer. The court of appeals correctly held that this substantive rule of Illinois law is not abridged—and that the burden of proof on Illinois tax

claims is not placed on the State—simply because the tax claim is litigated in bankruptcy court.

Except when Congress expressly provides otherwise, the substantive rules that allocate the burden of proof for a creditor's claim in non-bankruptcy cases also govern in bankruptcy proceedings. Nothing in the Bankruptcy Code expressly shifts the burden of proof to the taxing authority on tax claims litigated in bankruptcy court. To the contrary, while the Bankruptcy Code does contain several provisions that, in other contexts, explicitly address the burden of proof, there is nothing in the Code that establishes the "clear and manifest" intent (*BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 544 (1994)) required to displace the State's substantive rules governing the burden of proof on tax claims.

The legislative history of the Bankruptcy Code, and the prior practice under the Bankruptcy Act, also do not support petitioner's contention. The case law under the Bankruptcy Act had reached conflicting results. Some courts had concluded that the burden of proof shifts to the taxing authorities in bankruptcy; others had concluded that the burden was retained by the debtor. In this context, it cannot plausibly be suggested that congressional silence on the allocation of the burden of proof was intended to adopt any particular view.

Nor does Bankruptcy Rule 3001(f) prescribe a burden of proof on claims in bankruptcy. It provides only that the proof of claim executed by the claimant is "prima facie evidence" of the validity and amount of the claim. Fed. R. Bankr. P. 3001(f). That Rule does not purport to prescribe the ultimate burden of proof to be applied when the "prima facie" case established by the proof of claim is disputed by an objection in bankruptcy

court. This Bankruptcy Rule is subject to Rule 301 of the Rules of Evidence, which specifies that such a presumption merely imposes a "burden of going forward with evidence" "to rebut or meet the presumption" and "does not shift * * * the burden of proof in the sense of the risk of nonpersuasion." Fed. R. Evid. 301.

Petitioner also errs in suggesting that bankruptcy courts, as courts of equity, may disregard the substantive rules governing burden of proof established under non-bankruptcy law. Bankruptcy courts may not "contradict [the] statutory or common law" placing the burden of proof on taxpayers simply by invoking an "unrestricted power" to achieve "a fairer result" (*United States* v. *Noland*, 517 U.S. 535, 543 (1996)).

ARGUMENT

THE BANKRUPTCY CODE DOES NOT ALTER THE SUBSTANTIVE RULES THAT GOVERN THE BURDEN OF PROOF FOR TAX CLAIMS

1. It has long been the settled rule that, except as Congress provides otherwise, the burden of proof in litigation involving federal tax liabilities rests on the taxpayer. As this Court stated in *Helvering* v. *Taylor*, 293 U.S. 507, 515 (1935), "[u]nquestionably the burden of proof is on the taxpayer to show that the commissioner's determination is invalid." Accord *Bull* v. *United States*, 295 U.S. 247, 260 (1935); *Welch* v. *Helvering*, 290 U.S. 111, 115 (1933).[1] The rule placing

[1] This allocation of the burden of proof historically applied whether the tax claim was litigated in Tax Court in a deficiency proceeding (Tax Ct. R. 142(a)), in district court or the Court of Federal Claims in a refund case (*Bull* v. *United States*, 295 U.S. at 260), or in a tax collection action brought by the government in district court (*United States* v. *Rexach*, 482 F.2d 10, 15-18 (1st Cir.), cert. denied, 414 U.S. 1039 (1973); *Plisco* v. *United States*, 306 F.2d 784, 786 & n.2 (D.C. Cir. 1962), cert. denied, 371 U.S. 948 (1963)). In *United States* v. *Janis*, 428 U.S. 433, 440 (1976), the Court stated, without deciding, that "[t]he policy behind the presumption of correctness and the burden of proof * * * would appear to be applicable" in tax collection suits and that allocating the burden to the taxpayer in such suits would "accord[] * * * with the burden-of-proof rule which prevails in the usual preassessment proceeding in the United States Tax Court."

the burden of persuasion on the taxpayer was first developed as a judge-made rule of common law and was thereafter "repeatedly considered and approved by Congress." H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 238 (1998); S. Rep. No. 174, 105th Cong., 2d Sess. 43 (1998).[2] The States have also, by either statute or

[2] Congress has recently added Section 7491 to the Internal Revenue Code to provide that, "in any court proceeding," the burden of proof on factual issues relevant to ascertaining the taxpayer's federal tax liability will rest with the United States *if* the taxpayer satisfies the following conditions: (i) the taxpayer "introduces credible evidence" on the issue; (ii) the taxpayer has complied with substantiation requirements imposed by the Internal Revenue Code; (iii) the taxpayer has "maintained all records" required by the Internal Revenue Code, and "has cooperated with reasonable requests" for witnesses, information, documents, meetings, and interviews; and, (iv) in the case of a partnership, corporation or certain trusts, the taxpayer's net worth does not exceed $7 million, and it has no more than 500 employees. Internal Revenue Service Restructing and Reform Act of 1998, Pub. L. No. 105-206, Tit. III, § 3001(a), 112 Stat. 727 (to be codified at 26 U.S.C. 7491(a)). This new provision applies only to court proceedings that arise in connection with examinations commenced after July 22, 1998, or, in a case in which no examination occurred, to court proceedings arising in connection with taxable periods beginning, or events occurring, after July 22, 1998.

The new rules of Section 7491 also apply only to taxes imposed by Subtitles A ("Income Taxes") and B ("Estate and Gift Taxes") of the Internal Revenue Code. 26 U.S.C. 7491(a)(1). This provision

common law, routinely adopted this traditional allocation of the burden of proof to the taxpayer. See Amici States Br. Supporting Cert. at 6 n.3. In particular, the traditional rule has long been followed by the State of Illinois. Pet. App. A7; *Branson* v. *Department of Revenue*, 659 N.E.2d 961, 968 (Ill. 1995).

The court of appeals correctly concluded that the burden of proof in tax cases is not shifted to the taxing authority simply because the tax issue arises in the bankruptcy context. The *validity* of a creditor's claim is governed by substantive state and federal non-bankruptcy law. *Grogan* v. *Garner*, 498 U.S. 279, 283-284 & n.9 (1991) (non-bankruptcy law governs the standard of proof that a creditor must satisfy to establish a valid claim in bankruptcy); *Butner* v. *United States*, 440 U.S. 48, 55 (1979); *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156, 161 (1946). Rules allo-

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thus does not alter the traditional rule which places the burden of proof on the taxpayer in proceedings involving other types of taxes, such as employment taxes and excise taxes. In order to shift the burden of proof to the government, the taxpayer bears the burden of proving that the conditions imposed by 26 U.S.C. 7491 have been satisfied. If the taxpayer fails to sustain that burden, the ultimate burden of proof remains with the taxpayer. See S. Rep. No. 174, *supra*, at 45; H.R. Conf. Rep. No. 599, *supra*, at 242.

Even after enactment of Section 7491, the proper allocation of the burden of proof with respect to federal tax claims in bankruptcy proceedings thus remains of substantial importance to the United States. It is precisely in instances in which the taxpayer has *not* complied with the substantiation rules or has not cooperated with an investigation that the government would incur the greatest prejudice from bearing the burden of proof on tax claims in bankruptcy cases. Congress recognized that fact by leaving the burden of proof on the taxpayer in those situations "in any court proceeding." 26 U.S.C. 7491(a).

cating the burden of proof are part of the substantive law that governs a creditor's claim. *Director* v. *Greenwich Collieries*, 512 U.S. 267, 271 (1994) ("the assignment of the burden of proof is a rule of substantive law"); *Dick* v. *New York Life Ins. Co.*, 359 U.S. 437, 446 (1959); *Cities Service Oil Co.* v. *Dunlap*, 308 U.S. 208, 212 (1939). Except when Congress expressly provides otherwise, the substantive rules that allocate the burden of proof for a creditor's claim in non-bankruptcy cases therefore also govern in bankruptcy proceedings. See *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. at 161; 21 C. Wright & K. Graham, *Federal Practice and Procedure* § 5122 (1977). See also note 2, *supra*. The substantive rule of Illinois law, under which "the burden of proof, normally on the claimant, is shifted to the taxpayer" (*Bull* v. *United States*, 295 U.S. at 260), therefore governs in bankruptcy cases involving Illinois tax claims in the absence of a contrary federal statutory rule.

Petitioner acknowledges (Pet. Br. 7-8, 15) that the court of appeals correctly concluded (Pet. App. A11) that nothing in the Bankruptcy Code explicitly shifts the burden of proof to the taxing authority for tax claims adjudicated in bankruptcy court. See also *Franchise Tax Board of California* v. *MacFarlane*, 83 F.3d at 1045 ("[t]he bankruptcy code is silent on the allocation of the ultimate burden of proof" in tax disputes). Neither Section 502 of the Bankruptcy Code, which governs the allowance of claims generally, nor Section 505, which authorizes the bankruptcy courts to adjudicate tax disputes, contains any provision addressing or allocating the burden of proof. See 11 U.S.C. 502, 505. There is thus nothing in the Bankruptcy Code that establishes the "clear and manifest" intent (*BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 544 (1994)) that is re-

quired to displace substantive state and federal rules governing the burden of proof in the adjudication of tax claims.

As the court of appeals noted in this case (Pet. App. A11), the Bankruptcy Code *does* contain several provisions that, in other contexts, explicitly address the burden of proof. See, *e.g.*, 11 U.S.C. 362(g) (assigning burden of proof to different parties on different issues in challenges to automatic stay); 11 U.S.C. 363(o) (assigning burden to trustee on issue of adequate protection of creditors in hearing on use of creditor's property); 11 U.S.C. 364(d)(2) (assigning burden to trustee on issue of adequate protection in hearing on obtaining new credit); 11 U.S.C. 547(g) (assigning burden to trustee seeking to avoid certain allegedly preferential transfers); 11 U.S.C. 1129(d) (assigning burden to government of proving claim of tax avoidance as principal purpose of plan). As the court of appeals emphasized, the careful attention that Congress thus gave to burden-shifting rules in the Bankruptcy Code makes the legislative "silence on the burden of proof in tax cases eloquent." Pet. App. A11.

2. Petitioner errs in suggesting (Pet. Br. 26-27 & n.10) that the allocation of the burden of proof in bankruptcy cases should vary depending on whether it is the taxpayer or a creditor of the taxpayer who disputes the government's tax claim. The Bankruptcy Code reflects no intention by Congress to grant to creditors who contest the validity of a tax claim rights that are superior to the rights of the tax debtor himself.[3] The identity of the party who contests the tax

[3] Unless the court orders otherwise, both bankruptcy trustees and non-governmental creditors have the right to obtain information needed to contest the debtor's tax liability. See 11 U.S.C. 521(4) (imposing a duty on the debtor to "surrender to the trustee * * * any recorded information, including books, documents, records, and papers, relating to property of the estate"); 11 U.S.C. 704(7) (requiring the trustee to "furnish such information concerning the estate and the estate's administration as is requested by a party in interest"); Fed. R. Bankr. P. 4002 (imposing a duty on the debtor to "cooperate with the trustee in * * * the examination of proofs of claim"); 6 *Collier on Bankruptcy* ¶¶ 704.09[1], 704.11 (15th ed. rev. 1999); 9 *id.* ¶ 4002.05[2].

liability obviously has no bearing on the substantive question whether the debtor is in fact liable for the tax.

The general rule assigning the burden of proof on tax claims to the taxpayer stems from the government's "imperious need" for taxes, which are "the life-blood of government." *Bull* v. *United States*, 295 U.S. at 259. This need for prompt and efficient collection of tax revenues is not dissipated merely because the taxpayer has filed for bankruptcy. To the contrary, as the court of appeals emphasized (Pet. App. A11), shifting the burden of proof to the taxing authority in bankruptcy proceedings would simply make bankruptcy court a peculiarly favorable forum in which to dispute tax claims and thereby create an open invitation for abuse of the bankruptcy process. As the court emphasized (*ibid.*):

> The position for which the trustee contends * * * would create a new incentive to declare bankruptcy. We have enough bankruptcies.

The substantive rules of non-bankruptcy law that place the burden of proof for tax claims on the taxpayer have the salutary effect of requiring the taxpayer to maintain and produce appropriate records. See note 2, *supra*. By contrast, the opposite burden of proof rule for which petitioner contends would create a perverse

incentive for debtors to obstruct enforcement of tax claims simply by leaving their records in disarray. Neither logic nor the provisions of the Bankruptcy Code suggest that debtors should benefit at the expense of the public fisc from a failure to maintain and produce required tax records. The shifting of the burden of proof that petitioner proposes for tax claims litigated in bankruptcy court could yield inappropriate windfalls for tax protestors or others who seek to avoid tax debts in bankruptcy.

3. Congress has expressly granted priority to tax claims in bankruptcy cases. See, *e.g.*, 11 U.S.C. 507(a)(8). In doing so, the House Judiciary Committee explained that "[a] taxing authority is given preferred treatment [in bankruptcy] because it is an involuntary creditor of the debtor. It cannot choose its debtors, nor can it take security in advance of the time the taxes become due." H.R. Rep. No. 595, 95th Cong., 1st Sess. 189-190 (1978). The express legislative determination to give tax claims priority over the claims of other creditors in bankruptcy is manifestly inconsistent with petitioner's assertion that Congress determined, *sub silentio*, to treat tax claims less favorably when litigated in bankruptcy than when litigated outside of bankruptcy.

Petitioner's basic premise is that the burden of proof should be allocated to the government on a tax claim in bankruptcy court in order to treat the government like "[e]very other creditor who files a claim in a bankruptcy estate" (Pet. Br. 29). In making that assertion, however, petitioner fails to confront the fact that the validity of *any* creditor's claim in bankruptcy court—whether the creditor is a taxing authority or a non-governmental entity—is governed by the substantive rules of *non*-bankruptcy law. When, as with tax claims,

the rules of substantive non-bankruptcy law place the ultimate burden of proof on the debtor *outside* of bankruptcy, the debtor or trustee continues to shoulder that burden of proof in bankruptcy cases.

It is, of course, the ordinary rule that the claimant—either inside or outside of bankruptcy—bears the ultimate burden of proof. This is simply an application of the ordinary rule that a plaintiff generally bears the burden of proving his claim. But, when the substantive rule of non-bankruptcy law places the burden of proof on the defendant rather than the plaintiff, courts have recognized that the party *objecting* to the claim in bankruptcy must then bear the ultimate burden of proof in the bankruptcy case. As the Amici States have explained in detail (Amici States Br. Supporting Cert. at 9-11), the burden of proof is routinely assigned to the debtor in bankruptcy cases in *non*-tax contexts in which applicable non-bankruptcy law assigns that burden to the party in the debtor's position. See, *e.g.*, *In re Unioil, Inc.*, 962 F.2d 988, 994 (10th Cir. 1992) (burden of proving accord and satisfaction rests on the debtor as an affirmative defense); *In re Woehr*, 121 B.R. 743, 746-747 (N.D. Tex. 1990) (burden of proving debt is usurious rests on the debtor), aff'd, 957 F.2d 867 (5th Cir. 1992); *In re Andover Togs, Inc.*, 231 B.R. 521, 530 (Bankr. S.D. N.Y. 1999) (burden of proving laches); *In re Farris*, 194 B.R. 933, 936-937 (Bankr. E.D. Pa. 1996) (burden of proving Truth in Lending Act violation).

Contrary to petitioner's contention (Pet. Br. 18-20, 27), it is thus not a special dispensation to taxing authorities to apply the rules established under substantive non-bankruptcy law in allocating the burden of proof in bankruptcy cases. Instead, it would be a distinctive discrimination *against* taxing authorities to refuse to apply in bankruptcy cases the burden of proof

rules established under substantive non-bankruptcy law which govern the adjudication of such claims outside of bankruptcy court. Under our self-reporting systems of state and federal taxation, taxing authorities are obviously not in a position comparable to that of ordinary commercial creditors whose claims typically are based on transactions they had with the debtor that would be reflected in the creditors' own records. The practical realities of achieving fair resolution of tax disputes do not change merely because the issue arises in bankruptcy proceedings.

4. Petitioner asserts (Pet. Br. 10-15, 19-20) that, prior to the enactment of the Bankruptcy Code of 1978, the decisions of this Court in *City of New York* v. *Saper*, 336 U.S. 328 (1949), and *Nicholas* v. *United States*, 384 U.S. 678 (1966), had led the "vast majority of lower courts adjudicating objections to tax claims" (Pet. Br. 13) to place the ultimate burden of proof on the taxing authority. Petitioner contends that, if Congress wished to change this assertedly "established" law, it would have done so explicitly (Pet. Br. 19). Neither the decisions of this Court in *Saper* and *Nicholas*, nor the "vast majority" of lower court decisions, however, support petitioner in this case.

a. In *Saper*, this Court addressed whether the tax claim of the City of New York bore interest to the date the bankruptcy commenced or, instead, to the subsequent date on which the claim was paid. Prior to 1938, a number of courts had held that the claim of a taxing authority bears interest to the date of payment. 336 U.S. at 333. Congress had generally provided by statute, however, that interest would be allowed on bankruptcy claims only to the date the bankruptcy commenced. *Id.* at 330. The City nonetheless asserted that, by generally disallowing interest after the bankruptcy commenced, Congress had not intended to disturb the preexisting decisions that allowed interest on tax claims to the date of payment. *Ibid.* This Court rejected that contention because the statutory provision that generally disallowed interest on claims after commencement of the bankruptcy "contain[ed] no provision * * * allowing an exception in favor of tax claims." *Ibid.* It was in this specific context that this Court made the statements on which petitioner seeks to rely (Pet. Br. 12, 27): (i) that the enactment of amendments to the Bankruptcy Code in the Chandler Act of 1938, ch. 575, 52 Stat. 840, had "assimilated taxes to other debts for all purposes including the denial of post-bankruptcy interest" and (ii) that the Bankruptcy Code "requires governmental claims to be proved in the same manner and within the same time as other debts * * *." 336 U.S. at 332.

Neither of these isolated quotations from the decision in *Saper* has relevance to the present case. Indeed, petitioner has significantly misinterpreted the quoted text. When the Court referred to governmental claims being "proved in the same manner and within the same time as other debts" (336 U.S. at 332), the Court was *not* describing the method of proving a claim on the merits. Under the terminology employed under the Bankruptcy Act, prior to enactment of the Bankruptcy Code of 1978, a debt was "proved" in the sense described in *Saper* by the submission of a timely "proof of claims * * * under oath, in writing and signed by a creditor." 11 U.S.C. 93(a) (1939). Under Section 58(d) of the Bankruptcy Act, as amended in 1938, "[c]laims which have been duly proved" in this sense were to "be allowed * * * unless objection to their allowance shall be made by parties in interest * * * ." 11 U.S.C. 93(d) (1939). Thus, under the Bankruptcy Act terminology,

even when a claim was "proved" by the filing of a timely, verified "proof of claim," it was to be "allowed" upon objection only if the court thereafter determined that it was a valid and enforceable claim on the merits. See J. Moore, *Moore's Bankruptcy Manual* § 57, at 148 & n.1 (1939); 3A *Collier on Bankruptcy* ¶ 63.05 (14th ed. 1975). The ultimate burden of persuasion was simply not relevant to whether a claim was "proved" under the terminology employed in the Bankruptcy Act. The burden of persuasion became relevant only in determining whether a "proved" claim, to which objection had been made by a party in interest, would be "allowed" on the merits.[4] See 11 U.S. C. 93(d) (1939); J.

[4] Petitioner plainly errs in relying (Pet Br. 11) on the portion of the legislative history of the Chandler Act which states that governmental claims would "be subjected to the same requirements as other claims" under that Act. S. Rep. No. 1916, 75th Cong., 3d Sess. 5 (1938). In the Chandler Act, Congress for the first time required governmental claims to be filed and "proved" in the same manner as other bankruptcy claims. See 11 U.S.C. 93(n) (1939); J. Moore, *supra*, at 148 & n.1. The claims of the United States had formerly not been subject to the same time limits and "proof of claim" requirements imposed on other creditors. *Ibid.* ("[p]rovision in respect to government claims was added to avoid decisions which had held that the time limit [on submitting claims] was not binding upon the sovereign"). The language that petitioner quotes from the 1938 Senate report simply describes the newly adopted requirement that there be a timely "proof of claim" for government claims. The Senate Report generally agreed with the House proposal that, with respect to the requirement that "claims must actually be filed within the bar time," "governmental claims should be subject to the same requirements as other claims." S. Rep. No. 1916, *supra*, at 5. The Report went on to state, however, that this time "limitation should be tempered by [a] provision for extension, for the reason that it is sometimes difficult for the Government to prepare and present its claims within a fixed time." *Ibid.* By thus subjecting governments to the

Moore, *supra*, at 147. See also *In re Johns-Manville Corp.*, 57 B.R. 680, 686-687 (Bankr. S.D. N.Y. 1986).

In proper context, the quoted passages from *Saper* simply represent a straightforward application of the settled rule that, when Congress expressly and comprehensively addresses a particular subject, exceptions to the legislative rule are not lightly to be implied. 336 U.S. at 330. In the present case, unlike in *Saper*, it is undisputed that Congress has *not* expressly provided a general rule detailing the burden of proof for tax claims or other types of claims in bankruptcy. See Pet. Br. 19 (acknowledging "Congress' silence on the applicable burden of persuasion in claim objection proceedings"). Instead, each claimant comes to bankruptcy court with rights to be determined under substantive non-bankruptcy law. One of the substantive rights that governs the tax claim of the State of Illinois is the right to have the ultimate burden of proof placed on the party objecting to the claim. See page 11, *supra*. Since Congress has not provided a different rule, that substantive rule of state law governs the determination of the State's claim in bankruptcy court. See *ibid.*

b. The decision of this Court in the *Nicholas* case is similarly inapposite. In *Nicholas*, the Court again addressed the right of a taxing authority to receive interest on its claim in a bankruptcy case. In the circumstances of that case, the Court held that interest on taxes incurred after the commencement of a reorganization but before the conversion of that proceeding to a liquidation was not an administrative expense of

requirement of a timely "proof of claim," Congress did not purport, even by implication, to address the proper allocation of the burden of proof for determining whether a claim is ultimately to be "allowed" against the estate.

the bankruptcy estate. It was in this context that the Court made the statement in a footnote quoted by petitioner (Pet. Br. 12) that *Saper* "reflected an assimilation of tax debts to the status of other debts in bankruptcy." 384 U.S. at 682 n. 10. The fact that interest on tax debts was treated like interest on "other debts in bankruptcy" has no bearing on the question presented in this case.

c. Petitioner errs in asserting that, prior to the enactment of the Bankruptcy Code of 1978, "the vast majority of lower courts" (Pet. Br. 13) held that the taxing authority bears the burden of proof in establishing its claim. In the first place, none of the cases referred to by petitioner (Pet. Br. 13-15) suggests that either *Saper* or *Nicholas* is relevant to this issue. Moreover, petitioner cites only one decision of a court of appeals as support for its position. *United States* v. *Sampsell*, 224 F.2d 721 (9th Cir. 1955).[5] By contrast, two other courts of appeals had held under the Bankruptcy Act that the burden of proof rests on the party who objects to the tax claim. *In re Uneco, Inc.*, 532 F.2d 1204, 1207 (8th Cir. 1976); *Paschal* v. *Blieden*, 127 F.2d 398, 401-402 (8th Cir. 1942); *In re Lang Body Co.*, 92 F.2d 338, 341 (6th Cir. 1937), cert. denied *sub nom. Hipp* v. *Boyle*, 303 U.S. 637 (1938).

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[5] Petitioner erroneously cites (Pet. Br. 14) *Fiori* v. *Rothensies*, 99 F.2d 922 (3d Cir. 1938), and *Dickinson* v. *Riley*, 86 F.2d 385 (8th Cir. 1936), in this context. Neither of those cases addresses the proper allocation of the ultimate burden of proof. Petitioner also errs in citing (Pet. Br. 15) *In re Highway Construction Co. of Ohio*, 105 F.2d 863 (6th Cir. 1939), which ruled against the government claim simply because it had been rebutted by the debtor and the government had failed "to introduce evidence to establish its claim." *Id.* at 866.

The suggestion of petitioner (Pet. Br. 15-16, citing *Dewsnup* v. *Timm*, 502 U.S. 410, 419 (1992)) that Congress should be understood to have adopted "pre-Code practice" thus lacks any force in this case. No conclusion about legislative intent can be drawn from this conflicting precedent.

5. Petitioner incorrectly relies on the legislative history of the Bankruptcy Code of 1978. As petitioner notes (Pet. Br. 17), the House and Senate reports on that Act both state that a proof of claim constitutes "prima facie evidence of the claim" and that, in the absence of an objection by a party in interest, the claim is to be "allowed." H.R. Rep. No. 595, *supra*, at 352; S. Rep. No. 989, 95th Cong., 2d Sess. 62 (1978). The legislative reports further state that "[t]he burden of proof on the issue of allowance is left to the Rules of Bankruptcy Procedure." *Ibid.* Congress thus manifestly declined itself to adopt a general provision addressing the "burden of proof on allowance" in bankruptcy cases.

Petitioner incorrectly contends (Pet. Br. 17) that this Court adopted such a burden of proof rule by issuing Rule 3001(f) of the Bankruptcy Rules. That Rule specifies that (Fed. R. Bankr. P. 3001(f)):

> A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim.

That Rule, by its very terms, does no more than adopt the accepted proposition reflected in the legislative history that a properly filed proof of claim is "prima facie evidence" of the claim. Nothing in that Rule purports to establish an overriding, ultimate burden of proof rule to apply when the "prima facie" case is disputed by an objection in bankruptcy court. As the

Fourth Circuit explained in *In re Landbank Equity Corp*, 973 F.2d at 269, the "prima facie evidence" rule stated in Bankruptcy Rule 3001(f) is simply a procedural mechanism for facilitating administration of the bankruptcy estate. It places the burden of coming forward with some evidence to dispute the claim on the party who contests it; it does not address the question of who bears the ultimate burden of persuasion once the "prima facie" case has been placed at issue by the objecting party.[6] *Ibid.* Accord *In re Yoder Co.*, 758 F.2d 1114, 1119-1120 (6th Cir. 1985).

In this regard, Bankruptcy Rule 3001(f) parallels (and is subject to) Rule 301 of the Federal Rules of Evidence.[7] That rule of evidence, which applies to all cases in bankruptcy court, specifies that "*a presumption* imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but *does not shift* to such party *the burden of proof in the sense of the risk of nonpersuasion*, which remains throughout * * * upon the party on whom it was originally cast." Fed. R. Evid. 301 (emphasis added).

6. Petitioner also errs in suggesting (Pet. Br. 26, 29) that, because bankruptcy courts originated as courts of equity, they may disregard the substantive rules governing burden of proof established under non-bankruptcy law. As the court of appeals stated in this case

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[6] Moreover, because the allocation of the ultimate burden of proof is a part of the substantive rights of the claimant (see page 10, *supra*), the Bankruptcy Court rules could not lawfully "abridge, enlarge, or modify [that] substantive right." 28 U.S.C. 2075.

[7] The Federal Rules of Evidence are expressly applicable to all proceedings conducted in bankruptcy court. See Fed. R. Evid. 1101(a).

(Pet. App. 9a, quoting *In re Lapriano*, 909 F.2d 221, 224 (7th Cir. 1990)), "[b]ankruptcy is not a 'free-for-all equity balancing act.'" The equitable powers of a bankruptcy court "must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 206 (1988). As this Court stated in *Butner* v. *United States*, 440 U.S. 48, 56 (1979), "undefined considerations of equity provide no basis" for departing from substantive rules establishing a claimant's rights under non-bankruptcy law. Absent some "overruling federal law," the bankruptcy court may not alter the substantive rights of creditors established under non-bankruptcy law. *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. at 161. See also *United States* v. *Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986); *In re Morristown & Erie R.R.*, 885 F.2d 98, 100 (3d Cir. 1989); *Bird* v. *Carl's Grocery Co. (In re NWFX, Inc.)*, 864 F.2d 593, 595 (8th Cir. 1989). As this Court stated in *United States* v. *Noland*, 517 U.S. 535, 543 (1996) (quoting *In re Ahlswede*, 516 F.2d 784, 787 (9th Cir.), cert. denied, 423 U.S. 913 (1975)), "the [equity] chancellor never did, and does not now, exercise unrestricted power to contradict statutory or common law when he feels a fairer result may be obtained by application of a different rule." The Fourth Circuit correctly concluded in *In re Landbank Equity Corp.*, 973 F.2d at 271, that the fact that a bankruptcy court is a court of equity "does not confer on the court unlimited authority to ignore plain statutory requirements and to alter the substantive rights of the parties."

Placing the burden of proof on the taxing authority in bankruptcy cases would improperly disregard the substantive rights established under state and federal law. Congress did not itself "mean[] to shift the burden of proof from taxpayer to tax collector" in bankruptcy

cases. Pet. App. A11. Bankruptcy courts may not "contradict [the] statutory or common law" placing the burden of proof on taxpayers by invoking an "unrestricted power" to achieve what the court may consider to be "a fairer result" (*United States* v. *Noland*, 517 U.S. at 543). The court of appeals correctly held that the ultimate burden of proof for tax claims rests on the taxpayer as a matter of substantive law—regardless whether that claim is adjudicated inside, or outside, of bankruptcy.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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IN THE
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THOMAS E. RALEIGH, Chapter 7 Trustee
for the Estate of William J. Stoecker,
Petitioner,

v.

STATE OF ILLINOIS,
DEPARTMENT OF REVENUE,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

BRIEF OF PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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STATE OF ILLINOIS,
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BRIEF OF PENSION BENEFIT GUARANTY CORPORATION AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

INTEREST OF THE AMICUS CURIAE

The Pension Benefit Guaranty Corporation ("PBGC")[1] is a wholly owned United States government corporation

[1] PBGC is an "agency of the United States allowed by law to appear before this Court" within the meaning of Rule 37.4 of this Court's rules. Congress empowered PBGC "to sue and be sued, complain and defend, in its corporate name and through its own

created under Title IV of ERISA.[2] 29 U.S.C. § 1302. Modeled after the Federal Deposit Insurance Corporation, PBGC guarantees the payment of nonforfeitable benefits in defined benefit pension plans sponsored by private businesses. *See generally LTV*, 496 U.S. 633; *Nachman*, 446 U.S. 359. When a pension plan terminates with insufficient assets to pay promised benefits, PBGC takes over the assets and liabilities of the pension plan and pays guaranteed benefits to participants and their beneficiaries. 29 U.S.C. §§ 1322, 1342(c), (d), 1361. The statute then gives the agency a precisely defined, one-time claim against the employer (and related companies) for the shortfall. 29 U.S.C. § 1362(a), (b).

This case is important to PBGC because bankruptcy is the primary arena in which PBGC asserts its claims. During the period from 1975-98, most of the liabilities covered by PBGC's insurance fund arose from the bankruptcies of pension plan sponsors. Of the ten cases that have presented the largest claims against PBGC's insurance system in its 25-year history—resulting in a total exposure of $3.1 billion—eight involved bankruptcies.[3] In

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counsel, in any court, State or Federal." 29 U.S.C. § 1302(b)(1). PBGC has appeared before this Court through its own counsel both as a party, *see, e.g., PBGC v. LTV Corp.*, 496 U.S. 633 (1990); *Nachman Corp. v. PBGC*, 446 U.S. 359 (1980), and as an *amicus curiae, see, e.g., Concrete Pipe & Prods. of California, Inc. v. Construction Laborers Pension Trust*, 508 U.S. 602, 621 (1993); *Commissioner v. Keystone Consol. Indus.*, 508 U.S. 152, 162 n.3 (1993); *Mead Corp. v. Tilley*, 490 U.S. 714, 722, 726 (1989).

[2] The Employee Retirement Income Security Act of 1974, *as amended* ("ERISA"), 29 U.S.C. §§ 1301-1461 (1994 & Supp. III 1997).

[3] *See* PBGC, *Pension Insurance Data Book 1998* 11, 13-14, tab. S-12 (1999). A recent congressional report on PBGC's financial status warned:

> [A] few pension plans with extremely large unfunded liabilities have dominated PBGC's past claims . . . . PBGC's losses with respect to future terminations will depend on how well companies fund their plans, and on the PBGC's position in bankruptcy proceedings. Finally, pending litigation could have a material impact on the financial condition of the PBGC.

Staff of House Comm. on Ways and Means, 105th Cong., 2d Sess., 1998 Green Book: Background Materials and Data on Programs Within the Jurisdiction of the Comm. on Ways and Means 915 (Comm. Print 1998).

1998 alone, a year in which the economy was generally strong, PBGC was a claimant in several hundred bankruptcy cases nationwide, with claims totaling approximately $2.7 billion.[4]

This case calls upon the Court to decide whether the entitlements conferred upon a party by substantive nonbankruptcy law—here, the burden of proof under the Illinois Use Tax Act—may be cast aside by a bankruptcy court on the basis of equitable considerations. PBGC has an acute interest in this issue because in recent years, courts have disregarded ERISA in determining PBGC's bankruptcy claims, under the rubric of doing "equity" among creditors.

In 1987, Congress defined the amount of an employer's termination liability to PBGC as the "total amount of the unfunded benefit liabilities (as of the termination date)." 29 U.S.C. § 1362(b)(1)(A). Congress further directed that the "value" of the pension plan's benefit liabilities be determined "on the basis of assumptions prescribed by [PBGC]." 29 U.S.C. § 1301(a)(18). Years earlier,

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[4] PBGC's recurring appearance as a large claimant in Chapter 11 bankruptcies prompted Congress in 1994 to amend the definition of "person" in the Bankruptcy Code to include a governmental entity that "is a guarantor of a pension benefit payable by or on behalf of the debtor," 11 U.S.C. § 101(41)(B), so that PBGC could sit on creditors' committees, 11 U.S.C. § 1102(b)(1).

PBGC had promulgated a regulation prescribing those assumptions.[5] Thus, Congress mandated use of PBGC's regulatory assumptions against the backdrop of a specific, preexisting regulatory approach for calculating the amount of PBGC's claim.

Nevertheless, in recent years, courts have taken the position that this regulation, while valid outside of bankruptcy, should not be used to determine the amount of the claims asserted by PBGC in bankruptcy. For example, the Tenth Circuit recently held that "even though that methodology [in PBGC's regulation] was adopted in the exercise of PBGC's administrative authority, we have no doubt of its inapplicability in the world of bankruptcy." *PBGC v. CF&I Fabricators of Utah, Inc.* (*In re CF&I Fabricators of Utah, Inc.*), 150 F.3d 1293, 1301 (10th Cir. 1998), *cert. denied*, 119 S. Ct. 2020 (1999). The court instead relied on its own notion of equality among creditors to cut PBGC's claim in half. *Id.* Other lower courts have similarly spurned ERISA and the implementing regulations in favor of an "equitable" recalculation of PBGC's claims.[6]

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[5] PBGC's regulation for valuing pension plan liabilities was adopted on an interim basis in 1976 and finalized in 1981. The regulation was issued in full compliance with the notice and comment requirements of the Administrative Procedure Act, 5 U.S.C. § 553. *See* Valuation of Plan Benefits, 40 Fed. Reg. 57,982 (1975) (proposed rule); 41 Fed. Reg. 48,484 (1976) (interim rule); 46 Fed. Reg. 9492 (1981) (final rule), *codified as amended at* 29 C.F.R. § 4044.41-75 (1999), *amended by* 65 Fed. Reg. 14,752 (2000). The regulation produces a value of benefit liabilities in line with prices of insurance company annuity contracts. *See* 50 Fed. Reg. 5128 (1993) (proposed rule); 50 Fed. Reg. 50,812 (1993) (final rule).

[6] *See PBGC v. Belfance* (*In re CSC Indus.*), No. 95-4103, 1997 Bankr. LEXIS 2155 (Bankr. N.D. Ohio Dec. 3, 1997), *aff'd*, No. 4:99CV00041 (N.D. Ohio Aug. 10, 1999), *appeal docketed*, No. 99-4243 (6th Cir. Oct. 7, 1999); *LTV Corp. v. PBGC (In re Chateaugay Corp.)*, 130 B.R. 690, 695-96 (S.D.N.Y. 1991), *and* 126 B.R. 165 (Bankr. S.D.N.Y. 1991), *vacated by consent order*, 17 Employee Benefits Cas. (BNA) 1102 (S.D.N.Y. 1993).

Thus, PBGC has an extremely strong interest in whether bankruptcy courts are bound to adjudicate claims in accordance with the substantive nonbankruptcy law that gives rise to them. PBGC files this brief *amicus curiae* to urge the Court to conclude, in agreement with the Seventh and Fourth Circuits,[7] that notions of equity in bankruptcy may not be used to supplant substantive nonbankruptcy law. This proposition is true with respect to both state and federal laws, and is by no means unique to tax claims. Except where Congress so directs, bankruptcy courts do not have the authority to redefine entitlements under nonbankruptcy law.

SUMMARY OF THE ARGUMENT

Bankruptcy provides a forum in which all claims against a bankrupt entity may be asserted and dealt with in an expeditious manner. The grounds for these claims are as varied as the myriad commercial and legal relationships in which the bankrupt entity was involved prior to entering bankruptcy.

The Bankruptcy Code itself does not create claims. Thus, in dealing with claims against a debtor, a bankruptcy court must look to the substantive nonbankruptcy law to determine the validity and amount of each claim. The Court's precedents consistently indicate that a claimant's rights in bankruptcy are the same as they would be in the absence of bankruptcy, unless the Bankruptcy Code expressly alters those rights.

Section 502 of the Bankruptcy Code governs the determination of claims. Its language dictates that in the

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[7] *See In re Stoecker*, 179 F.3d 546 (7th Cir. 1999); *IRS v. Levy* (*In re Landbank Equity Corp.*), 973 F.2d 265, 270 (4th Cir. 1992).

event of a claims objection, the court is to determine the amount of the claim and allow it in that amount, except to the extent it is disallowable under any of the nine grounds listed in section 502(b).

Courts that have altered substantive rights in the interest of an uncodified policy of equality among creditors are mistaken. That equality relates to the distribution of the estate, and is embodied in other provisions of the Bankruptcy Code, such as the provisions that dictate that creditors in the same class receive pro rata shares of the estate. There is no need, nor any authority, for bankruptcy courts to substitute their notions of equality for those already embodied in the Bankruptcy Code.

The danger of permitting bankruptcy courts to alter the rights conferred by nonbankruptcy law on the basis of uncodified principles of equity is dramatically illustrated by several decisions involving PBGC's claims in bankruptcy. When a pension plan terminates, ERISA gives PBGC a claim against the plan sponsor for the plan's "unfunded benefit liabilities." ERISA also provides that the amount of unfunded benefit liabilities is to be calculated in accordance with assumptions prescribed in PBGC regulations. In several bankruptcy cases, however, courts have disregarded ERISA and the implementing regulation and recalculated PBGC's claim, purportedly in the interest of equality. In so doing, these courts have stripped tens of millions of dollars from the face amount of PBGC's claims.

This Court should affirm the Seventh Circuit and hold that bankruptcy courts are not free to alter the rights conferred by nonbankruptcy law, except as may be specifically provided in the language of the Bankruptcy Code.

ARGUMENT

1. When Congress defined a "claim" under the Bankruptcy Code broadly to include any "right to payment," 11 U.S.C. § 101(5), it assured that claims of virtually every possible origin could be brought before the bankruptcy court. Every claim against a debtor arises from a debtor-creditor relationship under *some* body of law—be it state or federal, statutory or common law. *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 169 (1946) (Frankfurter, J., concurring) ("Obligations to be satisfied out of the bankrupt's estate thus arise, if at all, out of tort or contract or other relationship created under applicable law."); *see also id.* at 161 (majority opinion).

At the same time, this Court has stated that Congress's constitutional power to establish "uniform Laws on the subject of Bankruptcies," U.S. Const. art. 1, § 8, allows it to alter the property rights established by nonbankruptcy law. *Butner v. United States*, 440 U.S. 48, 54-55 (1979). In those instances in which Congress has decided that administration of the bankruptcy laws requires alteration of parties' substantive rights, it has made its intention clear in the bankruptcy laws, as with the provisions governing trustees' avoidance powers, 11 U.S.C. §§ 545-51, 553, and the provisions respecting priority of distribution of the estate to claimants, 11 U.S.C. §§ 507, 726.

Here, the state law undisputedly allocates the burden of proof to the taxpayer, and no provision of the Bankruptcy Code expressly *re*allocates that burden of proof to the taxing authority.[8] Under principles that the Court's

[8] As the court of appeals noted, *see Stoecker*, 179 F.3d at 552, the Bankruptcy Code contains several provisions that allocate burdens of proof in certain matters, *see* 11 U.S.C. §§ 362(g), 363(o), 364(d)(2), 547(g), 1129(d), but none that reallocate to the taxing

decisions consistently recognize, the taxing authority's entitlement in bankruptcy is presumptively determined by substantive nonbankruptcy law.

In *Grogan v. Garner*, 498 U.S. 279 (1991), the Court noted the distinction between the dischargeability of claims, which since 1970 had been a matter of federal law governed by the Bankruptcy Code and its predecessor, *see* 11 U.S.C. § 523, and the *validity* of claims, which "is determined by rules of state law." 498 U.S. at 283 (citing *Vanston*, 329 U.S. at 161). This observation is consistent with the Court's other precedents that touch on the question of applicable law.

In *Butner v. United States*, for example, the Court referred to applicable state law when the relevant bankruptcy statute, in that case, the Bankruptcy Act, was silent on the matter. There, the question was whether a security interest in real property extended to rents, a question on which state laws differ. 440 U.S. at 50. The Court noted that although Congress clearly has plenary power to establish uniform laws respecting bankruptcies, *id.* at 54, it had not exercised this power with respect to a mortgagee's rights in real property of the estate, which "are created and defined by state law." *Id.* at 55. Thus, "[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 56.

Similarly, in a recent case involving the Bankruptcy Code's fraudulent conveyance provision, 11 U.S.C. § 548,

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authority the burden of proof on tax claims. Of these provisions, only section 1129(d) tangentially relates to taxes. That section prohibits a court from confirming a proposed plan of reorganization whose principal purpose is the avoidance of taxes or liability under the Securities Act of 1933

the Court held that whether a foreclosure sale provided "reasonably equivalent value" within the meaning of section 548 was governed by whether the sale was noncollusive and otherwise valid under the state law governing foreclosure sales. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 545 (1994). Since there was no "clear and manifest" indication of congressional intent to displace state foreclosure law, *id.* at 544, the legitimacy of the sale under state law controlled the question whether reasonably equivalent value had been received for the property. *Id.*

Though cases such as *BFP* and *Butner* deal with the circumstances under which state law should be applied in bankruptcy, *see BFP*, 511 U.S. at 544; *Butner*, 440 U.S. at 54-55, the Court has made the important observation that the relevant rule of law may come from federal law as well. "We use the term 'state law' expansively herein to refer to all nonbankruptcy law that creates substantive claims. We thus mean to include in this term claims that have their source in substantive federal law, such as federal securities law or other federal antifraud laws." *Grogan*, 498 U.S. at 284 n.9.[9] That is, in the context of bankruptcy, the issue is not so much whether, as a matter of federalism, to apply state law in the absence of overriding federal law, but whether, as a matter of choice-of-law, to apply nonbankruptcy law in the absence of overriding bankruptcy provisions. The latter view correctly recognizes that the Bankruptcy Code is essentially a procedural framework that provides a forum and procedures for expedient dispute resolution and distribution of the estate to creditors, but that "does not endeavor to supplant the substantive law," *Landbank Equity*, 973 F.2d

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[9] Indeed, as *Vanston* noted, the substantive rule of law may even stem from foreign law. 329 U.S. at 161 n.4.

at 270, except in ways clearly specified in the Bankruptcy Code.

2. Thus, the validity and amount of the claim of the Illinois Department of Revenue must be determined by reference to the law that gave rise to it, at least in the absence of some clear indication to the contrary in the Bankruptcy Code. And the language of the Bankruptcy Code—or more precisely, its eloquent silence, *Stoecker*, 179 F.3d at 552—makes clear that it has not displaced Illinois law in this respect. The remaining question, then, is whether, in the absence of an express reallocation of the burden of proof in tax cases, uncodified policies thought to be embodied in the Bankruptcy Code are a sufficient basis for overriding entitlements conferred by nonbankruptcy law. *See Franchise Tax Bd. v. MacFarlane (In re MacFarlane)*, 83 F.3d 1041, 1045 (9th Cir. 1996).

Petitioner's reliance on *Vanston* on this point, Brief for Petitioner at 23-24, is misplaced. Petitioner blurs *Vanston*'s recognition of the distinction between the allowability of a claim—i.e., the ability of a claim to share in the distribution of the estate—and the validity and the amount of the claim.[10] "What claims of creditors are valid and

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[10] The distinctions between the validity, provability, and allowability of bankruptcy claims under the Bankruptcy Act of 1898 were simplified by the enactment of the Bankruptcy Code, which abolished provability and codified the grounds for claim disallowance in section 502. As one court explained:

> Under the Bankruptcy Act of 1898, there are three distinct steps required to establish a claim. First, there must be a determination of the existence and amount of the liability based upon the prebankruptcy claim. Second, the claim must be "proved" in bankruptcy according to section 63 of the Act, 11 U.S.C. § 103 (1976) (repealed 1979). Third, if the claim is proved, the bankruptcy court must determine the claim's allowability under section 57 of the Act, 11 U.S.C. § 93 (1976) (repealed 1979).

Ohio v. Collins (In re Madeline Marie Nursing Homes), 694 F.2d 433, 437 (6th Cir. 1982); *see generally* Vern Countryman, *The Use of State Law in Bankruptcy Cases (Part I)*, 47 N.Y.U.L. Rev. 407, 426 (1972); Alfred Hill, *The Erie Doctrine in Bankruptcy*, 66 Harv. L. Rev. 1013, 1017 (1955).

subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed, is a question which, in the absence of overruling federal law, is to be determined by reference to state law." *Vanston*, 329 U.S. at 161. Once the amount of a claim is established, the allowability of the claim (and any distribution thereon) is determined by reference to the Bankruptcy Code. Recognizing this distinction, the Sixth Circuit has noted that equitable doctrines such as equitable subordination that are used to determine the allowability of claims "have never been applied . . . to oust state law in the original determination of the existence and amount of liability." *Unsecured Creditors' Comm. of Highland Superstores, Inc. v. Strobeck Real Estate (In re Highland Superstores, Inc.)*, 154 F.3d 573, 578-79 (6th Cir. 1998) (quoting *Madeline Marie*, 694 F.2d at 437); *accord Meindl v. Genesys Pac. Techs., Inc. (In re Genesys Data Techs., Inc.)*, No. 98-2270, 2000 WL 145105, at *3-4 (4th Cir. Feb. 9, 2000) (declining to create equitable exception to state law default judgment and 28 U.S.C. § 1738).[11]

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[11] Apart from the burden of proof area, the majority of cases to consider the question have concluded that nonbankruptcy law governs the validity and amount of a claim, and that any limits on allowance must be found in the Bankruptcy Code itself. *See Highland Superstores*, 154 F.3d at 578-79 (damages for lease rejection); *United States v. Sanford (In re Sanford)*, 979 F.2d 1511, 1513 (11th Cir. 1992) (penalties for failure to file tax returns); *Landsing Diversified Properties—II v. First Nat'l Bank & Trust Co. (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592, 595-97 (10th Cir. 1990) (attorney's fees under prepetition retainer agreement), *modi-*

Moreover, section 502 of the Bankruptcy Code has now largely subsumed *Vanston*'s discussion of the allowability of claims.[12] Under section 502, a claim (arising under whatever source of nonbankruptcy law) is presumptively deemed allowed. 11 U.S.C. § 502(a). In the event of an objection, section 502(b) dictates that after "determin[ing] the amount of [a] claim," the bankruptcy court "*shall allow* such claim in such amount," 11 U.S.C. § 502(b) (emphasis added), except to the extent it falls within one of nine (originally eight) enumerated exceptions. The language and structure of section 502 indicate that allowance is the rule, that disallowance is a matter of codified exceptions,[13] and that the determination of a

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fied on other grounds sub nom. Abel v. West, 932 F.2d 898 (10th Cir. 1991); *Murgillo v. California State Bd. of Equalization (In re Murgillo)*, 176 B.R. 524, 532 (B.A.P. 9th Cir. 1995) (sales tax); *cf. Madeline Marie*, 694 F.2d at 437-39 (6th Cir. 1982) (Medicaid overpayment) (Bankruptcy Act case); *United Merchants & Mfrs. v. Equitable Life Assurance Soc'y (In re United Merchants & Mfrs.)*, 674 F.2d 134, 137 (2d Cir. 1982) (contractual collection costs) (Bankruptcy Act case); *but see PBGC v. CF&I Febricators*, 150 F.3d at 1300-01 (pension liabilities under ERISA).

12 *Vanston* is part of a continuum of cases on the narrow subject of allowance of claims for postpetition interest. *See Vanston*, 329 U.S. at 163, 165. This question is now subsumed by section 502(b)(2) of the Bankruptcy Code, providing for disallowance of unmatured interest, and section 506(b), permitting interest on the claim of an oversecured creditor. *See United States v. Ron Pair Enters.*, 489 U.S. 235, 241-42 (1989); *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371-73 (1988); *Equitable Life Assurance Soc'y v. Sublett (In re Sublett)*, 895 F.2d 1381, 1386 (11th Cir. 1990).

13 Congress's addition of a ninth ground in 1994—for certain late-filed claims, *see* 11 U.S.C. § 502(b)(9)—further confirms that the section 502(b) exceptions are the exclusive grounds for disallowance. The legislative history of the Bankruptcy Code is in full accord. "Subsection (b) [of section 502] prescribes the grounds on which a claim may be disallowed. The court will apply these standards if there is an objection to a proof of claim." H.R. Rep. No. 95-595, at 352 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6308; S. Rep. No. 95-989, at 62 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848.

claim's amount remains a matter of substantive nonbankruptcy law.

Although there are a handful of areas in which bankruptcy law may be said to override relevant nonbankruptcy law, e.g., avoidance of certain transfers under 11 U.S.C. §§ 544, 545, 547, and 548, these areas are specifically set forth in the language of the Bankruptcy Code. By contrast, a bankruptcy court's freewheeling use of equitable principles on matters otherwise governed by the language and structure of the Bankruptcy Code is not permitted. For example, while section 510 of the Bankruptcy Code provides a bankruptcy court some discretion to subordinate a claim "under principles of equitable subordination," 11 U.S.C. § 510(c), a court's categorical subordination of tax penalties, even for ostensibly equitable reasons, effectively rewrites the priority schemes of sections 507 and 726 and is therefore impermissible. *United States v. Noland*, 517 U.S. 535, 540-41 (1996). "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988); *see Butner*, 440 U.S. at 56 (rejecting "undefined considerations of equity" as a basis for displacing applicable nonbankruptcy law).

Indeed, the courts that have replaced applicable nonbankruptcy law with their own notions of equity overlook that the relevant equitable principles are already embodied in the language and structure of Bankruptcy Code. For example, some courts have claimed that exercise of their equitable powers was necessary to assure equality among creditors. *See, e.g., MacFarlane*, 83 F.3d at 1045;

CF&I, 150 F.3d at 1301. However, as this Court has observed, such concerns are more aptly directed to *distribution* of the estate. "Equality of distribution among creditors is a central policy of the Bankruptcy Code. According to that policy, creditors of equal priority should receive pro rata shares of the debtor's property." *Begier v. IRS*, 496 U.S. 53, 58 (1990); *see also* cases cited in Brief for Petitioner at 22 n.9, 26. This equality of distribution is already embodied in the provisions of the Code. *See, e.g.*, 11 U.S.C. § 1122 (requiring that Chapter 11 plans of reorganization classify claims or interests together only if they are "substantially similar"); *id.* § 1123(a)(4) (requiring that plans of reorganization "provide the same treatment for each claim or interest of a particular class").

The *MacFarlane* court's belief that it is unfair for the government to receive a "double benefit," 83 F.3d at 1045 (i.e., both a shift in the burden of proof on the question of the claim's validity, and eventual priority in distribution if the claim is ultimately allowed), is a nearsighted view of fairness. If the validity and amount of each claim are determined in accordance with the law that gave rise to it, and the assets of the estate are distributed in accordance with Congress's chosen distribution scheme, that is the very essence of fairness under the Bankruptcy Code. Each creditor receives the benefit of its bargain or statutory entitlement, which in each case was undertaken with some risk of eventual debtor insolvency. By contrast, it is unfair to strip one creditor of substantive rights simply because its claim is larger, its burden of proof is lower, or its entitlement is otherwise different from those of other creditors. As the Court noted in *Butner*, supplanting the relevant nonbankruptcy law on the basis of "undefined considerations of equity" is actually *in*equitable because it "affords the [debtor]

rights that are not his as a matter of state law." 440 U.S. at 56. The Court likewise condemned the "opposite inequity": by conferring new rights on a debtor, a bankruptcy court concomitantly deprives one or more creditors of some right or interest to which they are entitled under applicable law. *Id.*

3. There are important policy reasons that bankruptcy courts should be required to apply substantive nonbankruptcy law in determining the validity and amount of claims. Such a requirement assures consistency in adjudication, in that applications of nonbankruptcy law will not vary depending on whether the forum is a state court, an Article III court, or a federal bankruptcy court. "Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" *Butner*, 440 U.S. at 55 (citing *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 609 (1961)).

Moreover, if substantive nonbankruptcy law is made less onerous (or suspended altogether) when applied in the context of bankruptcy, businesses and individuals have new incentives to declare bankruptcy, a factor the Seventh Circuit noted in this case.[14] If a taxpayer knew, for example, that it had a tax liability, but that the government would have difficulty proving the liability, bankruptcy could be an effective means of avoiding the liability.

Indeed, the abuse that is possible when relevant nonbankruptcy law is modified in determining the validity and

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[14] 179 F.3d at 552 ("The position for which the trustee contends has no more basis in the Code than in the law of Illinois, and it would create a new incentive to declare bankruptcy. We have enough bankruptcies.").

amount of a bankruptcy claim is dramatically illustrated by the treatment of PBGC's claims in bankruptcy. ERISA explicitly provides that a claim for "the total amount of unfunded benefit liabilities" of a terminated pension plan, 29 U.S.C. § 1362(b), is to be calculated using assumptions prescribed in PBGC regulations, 29 U.S.C. § 1301(a)(18).[15] PBGC has promulgated such a regulation, *see* 29 C.F.R. pt. 4044, and applied it in literally hundreds of pension plan terminations. Not a single court has held the regulation invalid.

Yet companies whose pension plans have had funding shortfalls in the hundreds of millions of dollars have successfully persuaded bankruptcy courts to disregard ERISA and PBGC's implementing regulation in favor of a debtor-oriented method of calculating the claim. For example, in *PBGC v. CF&I Fabricators*, the Tenth Circuit acknowledged that PBGC's regulation would have "the force of law" in other contexts, but held that it should not be followed in bankruptcy. 150 F.3d at 1301. "Even though that methodology was adopted in the exercise of PBGC's administrative authority, we have no doubt of its inapplicability in the world of bankruptcy." *Id.* In this way, bankrupt debtors have cut PBGC's termination liability claims to a fraction of their true amount, even before PBGC's recovery was further cut by the pro rata distribution to all unsecured creditors.

The results have been staggering. Alternative theories for calculating PBGC's claim have been substituted in

[15] "In a situation of this kind, Congress entrusts to the [agency], rather than to the courts, the primary responsibility for interpreting the statutory term." *Batterton v. Francis*, 432 U.S. 416, 425 (1977). *Accord Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-45 (1984). Such express delegations give rise to legislative rules that have the "force and effect of law." *Chrysler Corp. v. Brown*, 441 U.S. 281, 295 (1979); *Batterton*, 432 U.S. at 425 n.9.

three cases litigated to a decision.[16] Against CF&I, PBGC's termination liability claim was sliced from $221 million to $123 million. In *LTV*, had the parties not reached settlement during the pendency of the appeal in that case, the bankruptcy court's ruling would have effectively reduced the agency's claim from $222 million to about $158 million. And in *CSC Industries*, the debtor's theory slashed the claim from $48 million to only $2 million. The pressures to seek bankruptcy protection are evident, when supposed equitable considerations can be used to eliminate or substantially reduce such multimillion dollar claims.

A bankruptcy court's refusal to determine the validity and amount of claims in accordance with substantive nonbankruptcy law can also lead to anomalous results in situations in which liability is joint and several. Under ERISA, liability of members of a controlled group[17] is joint and several. 29 U.S.C. § 1362(a). But if provisions of ERISA and applicable regulations may be disregarded in bankruptcy, the amount of a bankrupt controlled group member's liability may be substantially less than that of a nonbankrupt controlled group member.[18] Thus, the perverse incentives that would obtain in a system that does not apply the nonbankruptcy law to determine the validity and amount of claims are by no means limited to the burden of proof in taxation cases.

[16] *See* cases cited *supra* at 4 & n.6.

[17] A "controlled group" is a group of trades or businesses under common control, e.g., a parent corporation and its 80-percent owned subsidiaries. *See* 29 U.S.C. § 1301(a)(14); I.R.C. § 414(b), (c); 29 C.F.R. § 4001.3; Treas. Reg. 1.414(b)-1, (c)-2.

[18] Similarly, in a tax case such as this one, the shift of the burden of proof in bankruptcy could result in exoneration from tax liability of one jointly liable party, but not its nonbankrupt co-liable affiliate, simply because the former enjoyed a reallocated burden of proof.

Bankruptcy decisions that disregard nonbankruptcy law may also lead to distortions in regulatory and enforcement programs as agencies search for ways to neutralize bankruptcy judges' equitable impulses. For example, decisions like *CF&I* would make it advantageous for PBGC to terminate pension plans *before* companies declare bankruptcy, even though ERISA encourages the continuation of pension plans. *See* 29 U.S.C. § 1302(a)(1). Of course, upon termination of a pension plan, active employees cease accruing service credit, and all participants lose benefits exceeding PBGC's guarantee.

The conclusion that uncodified bankruptcy policies override other statutory schemes is a particularly dangerous rule for governmental entities, which depend on uniform compliance with their regulatory programs. As this Court said nearly a century ago, if Congress intended a bankruptcy exception to the general law, "the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt." *Swarts v. Hammer*, 194 U.S. 441, 444 (1904), *quoted with approval in Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 502 (1986).

PBGC urges the Court to provide needed guidance to the lower courts with respect to all bankruptcy claims, not just tax claims. Otherwise, lower courts may confine the Court's decision to claims involving taxes, or burdens of proof, while continuing to wield their equitable swords when adjudicating claims that originate in other areas of nonbankruptcy law. The Court can avoid that result by confirming that, in determining the validity and amount of a claim in bankruptcy, a court must apply the nonbankruptcy law that gave rise to the claim, and must then, as the language of the Bankruptcy Code instructs,

allow the claim in the amount so determined, except to the extent one of section 502(b)'s nine exceptions limits allowance.

CONCLUSION

For the foregoing reasons, the Court should affirm the decision of the court of appeals.

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THOMAS E. RALEIGH, Chapter 7 Trustee
for the Estate of William J. Stoecker,
Petitioner,

v.

STATE OF ILLINOIS,
DEPARTMENT OF REVENUE,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals
for the Seventh Circuit**

BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, NATIONAL LEAGUE OF CITIES, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL ASSOCIATION OF COUNTIES, U.S. CONFERENCE OF MAYORS, INTERNATIONAL MUNICIPAL LAWYERS ASSOCIATION, AND INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION AS *AMICI CURIAE* SUPPORTING RESPONDENT

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QUESTION PRESENTED

Whether federal bankruptcy courts are bound by state law burdens of proof when state tax claims are litigated in bankruptcy.

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INTEREST OF THE *AMICI CURIAE*

Amici, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling interest in legal issues that affect state and local governments.[1] *Amici* regularly file briefs in this Court in cases that present important questions concerning the relationship between state and federal law.

The position advanced by Petitioner in this case, that federal bankruptcy courts are empowered to disregard the extensive body of state law addressing the burden of proof in tax litigation, *see* Appendix, would effect a very substantial displacement of state law in a core area of state regulatory authority. Petitioner's position is unsupported by this Court's precedents and is contrary to the Court's long-held view that "Congress and this Court repeatedly have shown an aversion to federal interference with state tax administration." *National Private Truck Council, Inc. v. Oklahoma Tax Comm'n*, 515 U.S. 582, 586 (1995).

Amici are also concerned that adoption of Petitioner's position will substantially disrupt state and local government tax administration, encourage bankruptcy filings, and unfairly impose additional monetary burdens on innocent taxpayers. *Amici* accordingly file this brief to assist the Court in its resolution of this case.

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[1] Pursuant to Rule 37.3 of the Rules of this Court, the parties have consented to the filing of this brief and their letters of consent filed with the Clerk. Pursuant to Rule 37.6, *amici* state that this brief was not authored in whole or in part by counsel for a party, and no person other than *amici* or their members made a monetary contribution to the preparation or submission of this brief.

SUMMARY OF ARGUMENT

A. When construing federal legislation in an area historically subject to state authority, this Court begins with the "basic assumption that Congress did not intend to displace state law." *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981). Consequently, in bankruptcy as in other areas, "[t]o displace traditional state regulation . . . the federal statutory purpose must be 'clear and manifest.' Otherwise the Bankruptcy Code will be construed to adopt, rather than displace, pre-existing state law." *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544-45 (1994) (citations omitted). Federalism concerns apply with particular force when bankruptcy courts adjudicate state tax disputes. *See National Private Truck Council, Inc. v. Oklahoma Tax Comm'n*, 515 U.S. 582 (1995).

It is within this framework that the Court must evaluate the ruling below. It is a fundamental principle of tax law that the burden of proof in tax disputes is ordinarily on the taxpayer. Because the burden of proof is an integral part of a litigant's substantive right, the burden of proof is not within the common law rulemaking authority of the federal bankruptcy courts. Rather, it is a carefully conceived aspect of state law in every State. Congress cannot displace these laws absent a clear statement to that effect.

B. Nothing in the Bankruptcy Code intimates, much less clearly states, that bankruptcy courts can ignore state law burdens of proof when adjudicating state tax claims. Moreover, Congress has directly addressed the burden of proof in several other aspects of bankruptcy litigation. As the court of appeals noted, "the close attention that the drafters of the Code paid to issues of burden of proof makes their

silence on the burden of proof in tax cases eloquent." Pet. App. 11a.

Congress's silence on the burden of proof in tax disputes is particularly significant given the Court's longstanding directive to bankruptcy courts to apply state law when determining the validity of a state law claim. Nor is there any federal interest requiring a different result. Bankruptcy courts should therefore apply the burden of proof provided by state law when adjudicating the validity of state tax claims.

Petitioner's argument that Congress adopted a prevailing pre-Code judicial construction placing the burden of proof on taxing authorities is unpersuasive for three reasons. First, there was no pre-Code practice placing the burden on the taxing authority when tax claims were litigated in bankruptcy court. Second, even if there arguably was such a pre-Code practice on burden of proof, this Court has never suggested that preemption of state law would be appropriate absent a clear and manifest indication in the Code. Inferential preemption of the kind urged by Petitioner would be flatly contrary to core notions of federalism.

Finally, Petitioner's pre-Code practice argument asks the wrong question. What is at issue is not the burden of proof ultimately applied but the source of the law that supplies that burden of proof. In many pre-Code cases involving disputed tax claims courts placed the burden of proof on the party that would have carried that burden in the non-bankruptcy setting, thus demonstrating the appropriate respect for state law.

C. Petitioner's argument that the bankruptcy court's equitable powers enable the court to reallocate

the burden of proof on tax claims is meritless. "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988). Nothing in the Bankruptcy Code supports allowing bankruptcy courts to use their equitable powers categorically to reallocate burdens of proof.

On the contrary, in *United States v. Noland*, 517 U.S. 535 (1996), this Court held that a bankruptcy court inappropriately invades the legislative sphere when it uses its equitable powers categorically to override the legislatively-created rights of creditors. Permitting bankruptcy courts to reallocate burdens of proof to balance the equities between the State and other creditors, as Petitioner advocates, is irreconcilable with *Noland*. Moreover, there is no policy in the Code that all creditors should receive equality of treatment, as is illustrated by the fact that the claims of tax creditors are expressly given priority over the claims of certain other creditors.

D. The consequences of permitting federal bankruptcy courts to shift the burden of proof from the taxpayer to the taxing entity weigh heavily in favor of rejecting Petitioner's position. A categorical federal rule that placed the burden of proof on the State in tax claims litigated in bankruptcy court would substantially disrupt state tax administration, encourage bankruptcy filings to avoid taxes, and be unfair to innocent taxpayers. Bankruptcy courts should not be permitted to supplant settled state law and wreak such harmful consequences absent a clear congressional directive. Because such a directive is plainly lacking, the judgment of the court of appeals should be affirmed.

ARGUMENT

FEDERAL BANKRUPTCY COURTS ARE BOUND BY STATE LAW BURDENS OF PROOF WHEN STATE TAX CLAIMS ARE LITIGATED IN BANKRUPTCY

A. Congress Must Clearly Indicate Its Intention To Displace State Law In Vital Areas Of State Regulation Such As Taxation

When construing federal legislation in an area historically subject to state authority, this Court begins with the "basic assumption that Congress did not intend to displace state law." *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981). This reluctance to find preemption in an area of traditional state control is essential to "avoiding unintended encroachment on the authority of the States." *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 664 (1993). As the Court recently reaffirmed,

> Federal statutes impinging upon important state interests 'cannot . . . be construed without regard to the implications of our dual system of government . . . . [W]hen the Federal Government takes over . . . local radiations in the vast network of our national economic enterprise and thereby radically readjusts the balance of state and national authority, those charged with the duty of legislating [must be] reasonably explicit.'

BFP v. Resolution Trust Corp., 511 U.S. 531, 544 (1994) (quoting *Kelly v. Robinson*, 479 U.S. 36, 49-50, n.11 (1986) (quoting Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 539-40 (1947))).

These principles are fully applicable in bankruptcy, as the Court made clear in *BFP*. "To displace traditional state regulation . . . the federal statutory pur-

pose must be 'clear and manifest.' Otherwise the Bankruptcy Code will be construed to adopt, rather than to displace, pre-existing state law." 511 U.S. at 544-45 (citations omitted). "The Bankruptcy Code can, of course, override [state law] by implication when the implication is unambiguous. But where the intent to override is doubtful, our federal system demands deference to long established traditions of state regulation." *Id.* at 546; *see also Kelly*, 479 U.S. at 49; *Butner v. United States*, 440 U.S. 48, 54-55 & n.9 (1979) ("State laws are . . . suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress."); *Stellwagen v. Clum*, 245 U.S. 605, 615 (1918) (same).

Federalism concerns apply with particular force when bankruptcy courts adjudicate state tax disputes. Recognizing that "[i]t is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments," this Court has long held that "it is of the utmost importance to all of them that the modes adopted to enforce the taxes levied should be interfered with as little as possible." *Dows v. Chicago*, 78 U.S. 108, 110 (1871). In *National Private Truck Council, Inc. v. Oklahoma Tax Comm'n*, 515 U.S. 582 (1995), the Court reiterated that "Congress and this Court repeatedly have shown an aversion to federal interference with state tax administration." *Id.* at 586. Acknowledging this "strong background principle against federal interference with state taxation," the Court emphasized that "principles of federalism and comity generally counsel that courts should adopt a hands-off approach with respect to state tax administration." *Id.* at 586, 589; *cf.* 28 U.S.C. § 1341 (Tax Injunction Act).

It is within this framework that the Court must evaluate the ruling below. It is a fundamental principle of tax law that the burden of proof in tax disputes is usually on the taxpayer. *See* Appendix; *Welch v. Helvering*, 290 U.S. 111, 115 (1933); *Helvering v. Taylor*, 293 U.S. 507, 515 (1935) ("[u]nquestionably the burden of proof is on the taxpayer to show that the [taxing authority's] determination is invalid").[2] The burden of proof is "a part of the very substance of [the] claim and cannot be considered a mere incident of a form of procedure." *Garrett v. Moore-McCormack Co.*, 317 U.S. 239, 249 (1942) (statutory right of plaintiff in admiralty case to be free of burden of proof "inhere[s] in his cause of action"); *see also Dick v. New York Life Ins. Co.*, 359 U.S. 437, 446 (1959) ("Under the Erie rule . . . burden of proof [is] substantive"); *Cities Serv. Oil Co. v. Dunlap*, 308 U.S. 208, 210-12 (1939). Consistent with these principles, the court below rightly acknowledged the "critical importance of burden of proof to a person's rights" and noted that "burden of proof is rightly classified as part of [a litigant's] entitlement." Pet. App. 10a. Consequently, as that court held, the burden of proof in state tax disputes is not within the rulemaking authority of the federal bankruptcy courts.

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[2] In some States this rule is subject to statutory exceptions. *See, e.g.*, Colo. Rev. Stat. Ann. § 39-21-105(b) (West 1990) (taxpayer does not carry burden of proof on issue of whether he is guilty of fraud with intent to evade tax); Del. Code Ann. tit. 30, § 526(a) (1974) (same); Ariz. Rev. Stat. Ann. § 42-1254(D)(4) (West Supp. 1999) (placing burden of proof on taxing authority in specified situations); Mo. Ann. Stat. § 136.300 (West Supp. 2000) ("The director of revenue shall have the burden of proof with respect to any factual issue relevant to ascertaining the liability of a taxpayer" in specified circumstances).

In this regard, the Court should also consider the disruptive consequences of reversing the judgment below. The longstanding rule placing the burden of proof on the taxpayer is a carefully conceived aspect of federal, state, and local tax law. It is based on the taxpayer's superior access to the relevant evidence. A rule requiring the taxing authority to bear the burden of proof when asserting a claim against a debtor in bankruptcy proceedings would preempt at least some aspect of tax law in every State, thus undermining carefully considered legislative and judicial determinations. *See* Appendix.[3] State legislatures have broad authority over taxation and can exercise it to alter the burden of proof in circumstances in which they conclude it is warranted. Thus, a categorical rule shifting the burden to the taxing authority in all bankruptcy proceedings would disturb the carefully considered schemes of the States which balance the competing interests of the taxpayer and the taxing authority.

B. The Code Does Not Intimate, Much Less Clearly Indicate, That Congress Intended To Displace State Law Burdens Of Proof When State Tax Claims Are Litigated In Bankruptcy

1. *The Bankruptcy Code Is Silent On Burdens Of Proof In State Tax Disputes And Therefore Federal Bankruptcy Courts Must Apply State Law*

This Court has consistently held that the validity of a claim in bankruptcy court "is a question which, in the absence of overruling federal law, is to be determined by reference to state law." *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156,

[3] The Appendix identifies at least one law in each State that places the burden of proof on the taxpayer.

161 (1946); *see also Butner*, 440 U.S. at 55; *Grogan v. Garner*, 498 U.S. 279, 283 (1991) ("The validity of a creditor's claim is determined by rules of state law.").[4] In *Butner*, the Court held that because Congress had not formulated a rule "defining the mortgagee's interest in the rents and profits earned by property in a bankrupt estate," 440 U.S. at 54, such interest must be determined by reference to state law. Noting that "[p]roperty interests are created and defined by state law," the Court ruled that "[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 55.[5]

Nothing in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure intimates, much less clearly states, that bankruptcy courts may ignore state law burdens of proof when adjudicating state

[4] *See also Bryant v. Swofford Bros. Dry Goods Co.*, 214 U.S. 279, 290-91 (1909) ("in bankruptcy the construction and validity of such a contract must be determined by the local laws of the state"); *Security Mortgage Co. v. Powers*, 278 U.S. 149, 158 (1928) (validity of a lien is determined by state law).

[5] As Professor Countryman observed with respect to the predecessor to the Bankruptcy Code,

> [T]he bankruptcy process deals with an existing condition . . . [a]nd the Bankruptcy Act does not provide a body of law, to be applied retroactively, in the establishment of claims. Hence the existence and amount of a bankrupt's liabilities, though determined by the bankruptcy court in allowing or disallowing claims, will inevitably be determined by non-bankruptcy, usually state, law.

Vern Countryman, *The Use of State Law in Bankruptcy Cases (Part I)*, 47 N.Y.U. L. Rev. 404, 412 (1972).

tax claims. The Code establishes that a claim or interest properly filed under section 501 will be allowed unless a party in interest objects. *See* 11 U.S.C. § 502(a) (1994). The Rules further provide that a proof of claim properly filed "shall constitute prima facie evidence of the validity and amount of the claim." *See* Fed. R. Bankr. P. 3001(f). Neither of these provisions speaks to the method by which the validity of a claim should be determined when disputed by a party in interest.

Moreover, Congress has directly addressed the burden of proof in several aspects of bankruptcy litigation. *See, e.g.*, 11 U.S.C. § 362(g) (assigning burden of proof in challenges to automatic stay); 11 U.S.C. § 363(o) (assigning trustee burden of proof on adequate protection issue in hearings on use of property); 11 U.S.C. § 364(d)(2) (assigning trustee burden of proof on adequate protection issue in hearing on obtaining credit); 11 U.S.C. § 547(g) (assigning burden with respect to avoidability of certain allegedly preferential transfers); 11 U.S.C. § 1129(d) (assigning to government burden of proving claim of tax avoidance as principal purpose of plan).[6] As the court of appeals noted, "the close attention that the drafters of the Code paid to issues of burden of proof makes their silence on the burden of proof in tax cases eloquent." Pet. App. 11a (citations omitted).

Congress's silence on the burden of proof in this context is particularly significant given the Court's longstanding directive to bankruptcy courts to apply state law when determining the validity of a state

[6] *See also* Fed. R. Bankr. P. 4003(c) (party objecting to exemption bears burden); Fed. R. Bankr. P. 4005 (burden assigned to party objecting to discharge).

law claim, *see Vanston*, 329 U.S. at 161, a significance reinforced by the Code's legislative history.[7] Nor is there any federal interest requiring a different result. *See infra* p. 22. Bankruptcy courts should therefore apply the burden of proof provided by state law when adjudicating the validity of state tax claims.

Petitioner argues that cases like *Vanston* and *Grogan* establish that state law burdens of proof should govern the validity of the creditor's claim outside of bankruptcy, but that federal law burdens of proof should govern the allowance of claims under section 502. *See* Pet. Br. 23-24. Petitioner is incorrect. *Vanston* and *Grogan* hold that state law governs the validity of a claim in bankruptcy court, but that federal law governs the disallowance or the discharge of claims in bankruptcy. *See Vanston*, 329 U.S. at 161-63; *Grogan*, 498 U.S. at 283-84. Thus, in *Vanston* this Court explained:

> What claims of creditors are *valid* and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law. . . . In determining what claims are *allowable* and how a debtor's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits. . . . [B]ankruptcy courts must administer and enforce the Bankruptcy Act as interpreted

[7] The legislative history of the Code demonstrates that Congress was aware that "tax collection rules for bankruptcy cases have a direct impact on the integrity of the Federal, State, and local tax systems" and that "the tax collector . . . should not lose taxes which he has not had reasonable time to collect." S. Rep. No. 598, 95th Cong., 2d Sess., *reprinted in* 1978 U.S.C.C.A.N. 5787, at 5800.

> by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles.

329 U.S. at 161-63 (emphasis added) (citations omitted). The Court thus described two distinct processes to be followed by bankruptcy courts: courts should determine the validity of the creditor's claim under state law, and then determine whether the claim must nevertheless be disallowed pursuant to other provisions specified by Congress in the Bankruptcy Act. Indeed, the Court in *Vanston* went on to "assum[e] *arguendo*, that the obligation for interest on interest is valid under the law of New York, Kentucky, and the other states having some interest in the indenture transaction" before addressing "whether allowance of the claim would be compatible with the policy of the Bankruptcy Act." 329 U.S. at 162.

The Bankruptcy Code of 1978 likewise embodies the two distinct processes described in *Vanston*. Section 502 provides that when a trustee objects to a proof of claim filed by a creditor, a bankruptcy court "shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that" such claim is inconsistent with the eight specific bases for disallowing claims enumerated by Congress. *See* 11 U.S.C. § 502(b) (1994). Moreover, contrary to Petitioner's assertion, *Grogan* only confirms that under the Bankruptcy Code of 1978, as was the case pre-Code, the "validity of a creditor's claim [in bankruptcy court] is determined by rules of state law." 498 U.S. at 283 (citing *Vanston*, 329 U.S. at 161).[8]

[8] The Court's ruling in *Grogan* that "the issue of nondischargeability has been a matter of federal law governed by

Thus, bankruptcy courts should apply state law, including state law burdens of proof, when determining the validity of state tax claims.

2. *Pre-Code Practice Does Not Displace State Law Burdens Of Proof*

Petitioner argues that, when enacting the Bankruptcy Code, Congress adopted a "prevailing judicial construction" of the Bankruptcy Act that placed the burden of persuasion on taxing authorities. *See* Pet. Br. 15-20. Petitioner's argument based on pre-Code practice is unpersuasive for three reasons.

First, Petitioner has failed to establish a prevailing pre-Code practice placing the burden of proof on the taxing authority. This Court has found a prevailing pre-Code practice to exist when there is in fact a consensus among all, or nearly all, the courts addressing a given point. *See, e.g., Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998). In *Cohen*, this Court relied on a pre-Code practice established by provisions in the Bankruptcy Act of 1898 and this Court's precedent interpreting that Act. *Id.* The Court noted no contrary authority on the issue.[9]

terms of the Bankruptcy Code," 498 U.S. at 284, does not indicate, as Petitioner suggests, that federal burdens of proof should apply in this case. *See* Pet. Br. 24. Rather, the Court in *Grogan* simply reiterated that the validity of a claim should be governed by state law, but other bankruptcy inquiries, such as the discharge of a claim, should be governed by federal bankruptcy law. *See* 498 U.S. at 283-84.

[9] *See also Dewsnup v. Timm*, 502 U.S. 410, 418 & n.4, 419 (1992) (pre-Code practice established by provision of Bankruptcy Act and this Court's precedent; no contrary authority noted); *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 373 (1988) (pre-Code practice

In contrast, this Court has refused to find that a pre-Code practice exist[illegible] where the proffered practice is supported only by d[illegible]ided authority. *See United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 380-82 (1988). There, the Court pointed to seven bankruptcy court cases and the comments of a leading bankruptcy commentator as authority which contradicted the proffered pre-Code practice before concluding that "[t]he at best divided authority under Chapter 11 removes all cause for wonder that the alleged departure from it should not have been commented upon in the legislative history." *Id.* at 381-82.

Likewise, in the present case Petitioner has failed to establish a pre-Code practice placing the burden of proof on the taxing authority when tax claims are adjudicated in bankruptcy court. Petitioner himself acknowledges that five courts had placed the burden on the taxpayer rather than the taxing authority before the enactment of the Bankruptcy Code, and two courts required the objecting party to rebut the presumptive validity of tax claims by clear and convincing evidence. *See* Pet. Br. 15 n.5. Moreover, a review of the relevant case law demonstrates many more pre-Code cases placing the burden of proof on the taxpayer/debtor.[10] Finally, it is unclear whether

established by plain text of statute and this Court's precedent; no contrary authority noted); *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl'l Prot.*, 474 U.S. 494, 500-01 (1986) (pre-Code practice established by relevant circuit and bankruptcy cases; no contrary authority noted); *Kelly*, 479 U.S. at 44-46 (pre-Code practice established by this Court's precedent, court of appeals cases and leading commentator; one court of appeals case noted as contrary authority).

[10] *See, e.g., In re Shackelford*, 3 B.R. 42, 44 (Bankr. W.D. Mo. 1980); *In re Canady*, 43 A.F.T.R.2d 79-472, 473 (N.D. Ga. 1978); *In re Menefee*, 40 A.F.T.R.2d 77-5006, 5013 & n.19 (E.D. Mo. 1977); *In re Uneco*, 532 F.2d 1204, 1207 (8th Cir. 1976); *In re Certified Credit Corp.*, 329 F. Supp. 1402, 1403-04 (S.D. Ohio 1971); *In re Standard Milling Co.*, 324 F. Supp. 386, 390 (N.D. Tex. 1970); *In re Parr*, 205 F. Supp. 492, 498 (S.D. Tex. 1962); *In re Oxford Assoc.*, 209 F. Supp. 242, 243-44 (D.N.J. 1962); *In re Petersilge*, 70 F. Supp. 95, 96-97 (N.D. Ohio 1946); *Paschal v. Blieden*, 127 F.2d 398, 401-02 (8th Cir. 1942); *In re Raflowitz*, 37 F. Supp. 202, 207 (D. Conn. 1941); *In re Lasky*, 38 F. Supp. 24, 30 (N.D. Ala. 1941); *In re Gandolfi & Co.*, 42 F. Supp. 706, 707 (S.D.N.Y. 1940); *In re Mid America Co.*, 31 F. Supp. 601, 607 (S.D. Ill. 1939); *In re Lang Body Co.*, 92 F.2d 338, 341 (6th Cir. 1937), *cert. denied*, 303 U.S. 637 (1938); *United States v. Knox-Powell-Stockton Co.*, 83 F.2d 423, 425 (9th Cir. 1936), *cert. denied*, 299 U.S. 573 (1936); *In re Bell*, 34 F.2d 677, 680 (W.D. Pa. 1929); *In re Glover-McConnell Co.*, 9 F.2d 683, 686 (N.D. Ga. 1925).

each of the cases Petitioner cites (Br. 14-15) support the existence of a pre-Code practice placing the burden of proof on the taxing authority.[11] Thus, Petitioner establishes "at best, divided authority" as to which party bears the burden of proof when the validity of a tax claim is adjudicated in bankruptcy court. *United Savings Association*, 484 U.S. at 382.

Second, even if there arguably was such a pre-Code practice on burden of proof, this Court has never suggested that preemption of state law would be appropriate absent a clear and manifest indication in the Code.[12] Inferential preemption of the kind urged by

[11] *See, e.g., Fiori v. Rothensies*, 99 F.2d 922, 922 (3d Cir. 1938) (per curiam) (discussing prima facie value of taxing authority's claim, but failing to reach the issue of burden of proof).

[12] Indeed, in the leading cases in which both a pre-Code practice and issues of federalism were at stake, the Court

Petitioner would be flatly contrary to core notions of federalism that require Congress to clearly indicate its intention to displace state law. As the Court held in *BFP*, only a congressional intention that is "clear and manifest," 511 U.S. at 544, suffices to displace state law in the bankruptcy context. As *amici* have noted, it is a fundamental principle of state tax law that, with the exception of certain specifically delineated situations, the burden of proof in tax disputes falls upon the taxpayer. *See* Appendix. If this Court is to begin with the "basic assumption that Congress did not intend to displace state law," *Maryland v. Louisiana*, 451 U.S. at 746, it should find a congressional intent to adopt a pre-Code practice which displaces state substantive law only in the clearest and most compelling circumstances, which are not present here.

Finally, Petitioner's proffered pre-Code analysis should be rejected because it asks the wrong question. At issue here is not so much the burden of proof to be applied as the source of the law that determines how the burden is allocated. Thus, in terms of pre-Code practice, the more appropriate inquiry is whether pre-Code cases applied specific bankruptcy law burdens of proof or the burdens that applied under relevant non-bankruptcy law. A review of case law involving disputed tax claims indicates that many courts placed the burden of proof on the party which would otherwise have carried that burden under

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preserved state law. *See, e.g., Cohen*, 523 U.S. at 221, 223 (pre-Code practice respected State's interest in enforcement of state law judgment against debtor); *Dewsnup*, 502 U.S. at 417-19 (pre-Code practice preserved the result otherwise obtained under state law); *see also Midlantic*, 474 U.S. at 500; *Kelly*, 479 U.S. at 53.

non-bankruptcy law, thereby demonstrating an appropriate respect for state law.[13]

For all of these reasons, this Court should decline to find an intent of Congress to adopt a pre-Code practice placing the burden of proof on the taxing authority in state tax disputes.

C. The Bankruptcy Court's Equitable Power To Reorder Claims Does Not Empower It To Reallocate Burdens Of Proof

Petitioner contends that the bankruptcy court's equitable powers should be used to reallocate the burden of proving the validity of a tax claim in order to promote the policy of equality among creditors. *See* Pet. Br. 26-29; *see also Franchise Tax Bd. of California v. Macfarlane*, 83 F.3d 1041, 1045 (9th Cir. 1996) (shifting burden to taxing authority in order to "balance the equities," on grounds that taxing authority should not receive "double benefit," because tax claims also receive statutory priority over claims of other creditors), *cert. denied*, 520 U.S. 1115 (1997). This argument is without merit. The

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[13] *See, e.g., In re Shackelford*, 3 B.R. at 44 (citing non-bankruptcy law, or cases relying on nonbankruptcy law, when stating burden of proof); *accord In re Canady*, 43 A.F.T.R.2d at 473; *In re Menefee*, 40 A.F.T.R.2d at 5013 & n.19; *In re Uneco*, 532 F.2d at 1207; *In re Standard Milling Co.*, 324 F. Supp. at 390; *In re Oxford Assoc.*, 209 F. Supp. at 243-44; *In re Petersilge*, 70 F. Supp. at 96-97; *Paschal v. Blieden*, 127 F.2d at 401-02; *In re Lasky*, 38 F. Supp. at 30; *In re Glotzer*, 42 F. Supp. 712, 713 (S.D.N.Y. 1941); *In re Trustees System Co. of Louisville*, 30 F. Supp. 361, 363 (1939); *In re Candolfi & Co.*, 42 F. Supp. at 707; *In re Mid America Co.*, 31 F. Supp. at 60[illegible]; *In re Lang Body Co.*, 92 F.2d at 341; *United States v. Knox-Powell-Stockton Co.*, 83 F.2d at 424-25; *In re Bell*, 34 F.2d at 680; *In re Glover-McConnell Co.*, 9 F.2d at 686.

equitable powers of the bankruptcy court to reorder claims cannot be used to override the state law that determines the validity of a claim. In "balancing the equities," bankruptcy courts must also consider this Court's directive that, absent a contravening statement from Congress, creditors are entitled to the same substantive rights in bankruptcy court that they possess outside of bankruptcy. The goal of bankruptcy courts should be to ensure that the validity of a creditor's claim does not depend upon whether the claim is asserted in bankruptcy court or some other forum. This goal, rather than some undefined desire for equality among creditors, controls this case.

Bankruptcy courts are courts of equity. *See* 11 U.S.C. § 105(a). This Court has repeatedly held, however, that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988); *see also United States v. Noland*, 517 U.S. 535, 539 (1996) ("although [the bankruptcy court] is a court of equity, it is not free to adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result is inequitable"); *Butner*, 440 U.S. at 56 ("undefined considerations of equity provide no basis for adoption of a uniform federal [bankruptcy] rule").

The Bankruptcy Code does not state that bankruptcy courts may use their equitable powers categorically to shift the burden of proof in tax disputes. Petitioner nevertheless contends that bankruptcy courts are entitled to disregard state substantive law when determining the validity of a claim, if doing so

will promote "equality" among creditors. Pet. Br. 27; *see also Macfarlane*, 83 F.3d at 1045. Indeed, Petitioner asserts that "[i]n order to balance the equities between taxing authorities and other creditors, taxing authorities should shoulder the same burden of persuasion as other creditors to establish their claims." Pet. Br. 29.

Petitioner's argument is without merit. In *Noland*, this Court held that a bankruptcy court inappropriately invades the legislative function when it uses its equitable powers categorically to override the legislatively-created rights of creditors. 517 U.S. at 540-41. The *Noland* Court reasoned that the equitable powers of a bankruptcy court do not justify categorical subordination of claims where such subordination was at odds with Congress' articulated scheme of priorities. *Id.* The Court stated that bankruptcy courts could not categorically subordinate the claims of creditors—in this case the Internal Revenue Service—in derogation of Congress's ordering of priorities because doing so would contravene the reasoned policy judgment of the legislature. *See id.* at 543.

Despite *Noland*'s admonition that "bankruptcy courts may not take it upon themselves to make . . . categorical determination[s] under the guise of [equity]," 517 U.S. at 543, Petitioner advocates a rule that would require bankruptcy courts to do precisely that. Permitting bankruptcy courts to reallocate burdens of proof in order to "balance the equities 'between the [State] and other creditors' " or to avoid " 'granting the [State] a double benefit,' " *Macfarlane*, 83 F.3d at 1045 (citations omitted), is irreconcilable with *Noland*. Indeed, the rule that Petitioner seeks—that the burden of proof is always on the taxing entity in bankruptcy—is a blanket rule

of the very sort struck down by the Court in *Noland* as "inappropriately categorical in nature." 517 U.S. at 543.[14] Petitioner's request must be denied because this Court has already made clear that equitable powers do not authorize a bankruptcy court to "exercise unrestricted power to contradict statutory or

[14] Petitioner's suggestion that the equitable powers of the Court may be used to shift the burden of proof because the "'balance of equities between creditor and creditors' is at work when a bankruptcy court is called upon to adjudicate an objection to the allowance of a priority tax claim," Pet. Br. 29, is without merit. As discussed above, this case involves the burden of proof to be applied when determining the validity of the claim under state law, not the allowance of the claim under federal law. Moreover, it is questionable whether a bankruptcy court may use its equitable powers to disallow a claim when, as here, the creditor has engaged in no misconduct or fraud. *See, e.g., In re Mobile Steel Co.*, 563 F.2d 692, 699 (5th Cir. 1977) ("[E]quitable considerations can justify only the subordination of claims, not their disallowance."); *In re 80 Nassau Assoc.*, 169 B.R. 832, 837 & n.4 (Bankr. S.D.N.Y. 1994); *In re Babbin*, 164 B.R. 157, 160 (Bankr. D. Colo. 1994); *In re Georgia Villa, Inc.*, 10 B.R. 79, 85 (Bankr. N.D. Ga. 1981); *In re Huckabee Auto Co.*, 33 B.R. 132, 139-40 (Bankr. M.D. Ga. 1981); *see also* 4 Lawrence P. King, *Collier on Bankruptcy* ¶ 510.02 (15th ed. 1999) ("There are in addition, situations in which the claim of a creditor is enforceable at law and should be allowed, but where the creditor's misconduct requires an equitable remedy. In such a case, the valid claim will not be disallowed but will be subordinated, or postponed in rank, until the claims of other creditors have been satisfied.") (citing Asa S. Herzog & Joel B. Zweibel, *The Equitable Subordination of Claims in Bankruptcy*, 15 Vand. L. Rev. 83, 86 (1961) and Daniel C. Cohn, *Subordinated Claims: Their Classification and Rating Under Chapter 11 of the Bankruptcy Code*, 56 Am. Bankr. L.J. 293 (1982)); *cf. Pepper v. Litton*, 308 U.S. 295, 312 (1989) (acknowledging equitable powers of disallowance or subordination when creditor breached fiduciary duty).

common law when [the court] feels a fairer result may be obtained by application of a different rule." *Id.* at 543; *accord United States v. Reorganized CF & I Fabricators*, 518 U.S. 213, 229 (1996) ("categorical reordering of priorities that takes place at the legislative level of consideration is beyond the scope of judicial authority to order equitable subordination under § 510(c)").

Petitioner also contends that the Code's "fundamental goal of equality of treatment of creditors is put at risk if one class of creditors—and indeed, a class of creditors whose claims are often granted priority status—is given the benefit of a favorable presumption that is unavailable to other creditors." Pet. Br. 27. There is, however, no policy in the Code that all creditors should receive "equality of treatment" in bankruptcy proceedings. On the contrary, the Code expressly grants favorable treatment to tax creditors in other instances. *See, e.g.*, 11 U.S.C. § 507(a)(8) (priority of distribution); 11 U.S.C. § 523(a)(1) (nondischargeability of tax liability).[15] The decision to grant certain priorities to tax creditors is a reasoned congressional judgment reflecting the fact that taxing authorities are non-consensual

[15] Taxing authorities have a fundamentally different relationship with debtors than do most private creditors because they are public agencies and nonconsensual creditors. Most private creditors achieve through contract greater access to information with which to monitor the financial activities of their debtors than the government obtains on tax returns. *See* Frances R. Hill, *Toward A Theory Of Bankruptcy Tax: A Statutory Coordination Approach*, 50 Tax Law. 103, 107, 149 (1996). Moreover, private creditors can adjust the terms of credit to reflect risk. Consequently, Congress had valid reasons for providing taxing authorities with certain preferences in the bankruptcy context.

creditors. A bankruptcy court should not be permitted to undermine that judgment.[16]

In short, a bankruptcy court cannot invoke its powers of equity to "create equitable impediments for a certain class of creditors based on the notion that Congress has given [those creditors] too much." *Thinking Machines Corp. v. New Mexico Taxation & Revenue Dep't*, 211 B.R. 426, 431 n.7 (Bankr. D. Mass. 1997) (citation omitted). Rather, as this Court recognized in *Butner*, 440 U.S. at 56, unless Congress has mandated otherwise, "undefined considerations of equity provide no basis for adoption of a uniform federal rule" in bankruptcy that contravenes generally applicable state law rules.

D. Allowing Bankruptcy Courts To Reallocate Burdens of Proof Would Substantially Disrupt State Tax Administration, Encourage Bankruptcy Filings, And Be Unfair To Innocent Taxpayers

The adverse consequences of permitting federal bankruptcy courts to shift the burden of proof from the taxpayer to the taxing entity also weigh heavily in favor of affirming the judgment of the court of appeals. These consequences are distinctly at odds with the concerns expressed in the legislative history of the Bankruptcy Code.

> Since tax authorities are creditors of practically every taxpayer, . . . tax collection rules for bankruptcy cases have a direct impact on the integrity of the Federal, State, and local tax systems. These tax systems, generally based on voluntary assessment, work[] to the extent that the majority of taxpayers think they are fair. This presumption of fairness is an asset which should be protected and not be jeopardized by permitting taxpayers to use bankruptcy as a means of improperly avoiding their tax debts. To the extent that debtors in a bankruptcy are freed from paying their tax liabilities, the burden of making up the revenues thus lost must be shifted to other taxpayers.

S. Rep. No. 598 at 14, *reprinted in* 1978 U.S.C.C.A.N. at 5800. The Senate Report expressed particular concern that "the tax collector . . . should not lose taxes which he has not had reasonable time to collect or which the law has restrained him from collecting." *Id.*

"Claims for taxes figure prominently in nearly all bankruptcy proceedings." William T. Plumb, *The Tax Recommendations of the Commission on the Bankruptcy Laws—Tax Procedures*, 88 Harv. L. Rev. 1360, 1363 (1975). The allocation of the burden of proof frequently has a substantial impact on state revenue collection because the determination of which party bears the burden of proof in tax cases will often be "critical" to the ultimate outcome of the dispute, as it is in this case. *See* Pet. App. 8a. If the State is unable to collect taxes from debtors because of the reallocation of the burden of proof, it will necessarily pass on its losses to the general public in the form of higher taxes. *See Thinking Machines*, 211 B.R. at 431 n.8 (citing Hill, 50 Tax Law. at 112). Consequently, "other present and future taxpayers

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[16] As one commentator has observed, "It is scarcely a surprise to note that the government's claim for unpaid prepetition taxes may be afforded priority status in bankruptcy distribution. Indeed, perhaps the surprise is that the priority for taxes is as low as it is; taxes rank eighth in the priority line." Charles J. Tabb, *The Law of Bankruptcy* 520 (1997) (citing 11 U.S.C. § 507(a)(8)).

[will be] left to provide the revenue required for governmental operations," Hill, 50 Tax Law. at 107, potentially creating "concerns about the fairness of the distribution of the burden of funding the government." Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules*, 84 Iowa L. Rev. 413, 451-52 (1999).

Requiring bankruptcy courts to adjust the burden of proof for tax claims would be particularly disruptive because both federal and state tax systems rely upon voluntary compliance and self-reporting by citizens.[17] *See United States v. Bisceglia*, 420 U.S. 141, 145 (1975). The taxpayer, rather than the government, is the party most likely to possess relevant evidence regarding potential tax liability and is thus best able to carry the burden of proof in the event of any contest as to that liability. *See United States v. Rexach*, 482 F.2d 10, 16 (1st Cir.), *cert. denied*, 414 U.S. 1039 (1973). A taxing authority is a nonconsensual creditor who "has no discretion in choosing those from whom it must collect taxes" and "no ability to monitor debtors and could gain no benefit from doing so." Hill, 50 Tax Law. at 149.

Indeed, both the court below and other courts have recognized that permitting bankruptcy courts to shift the burden of proof in tax disputes would "create a new incentive to declare bankruptcy." Pet. App. 11a.[18]

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[17] Indeed, the current allocation of the burden of proof is in harmony with rules requiring taxpayers adequately to document their financial affairs. *See United States v. Rexach*, 482 F.2d 10, 16 (1st Cir.), *cert. denied*, 414 U.S. 1039 (1973).

[18] *See also Barrows v. Internal Revenue Serv.*, 231 B.R. 446, 452 (Bankr. D.N.H. 1998) (stating that "if the burden of proof was allocated differently between the bankruptcy forum and other forums, there would be a great incentive for taxpayers to forum shop. Simply by filing for bankruptcy, the taxpayer could shift the potential responsibility for establishing the validity and amount *vel nom* of a tax claim to the taxing authority."); *Thinking Machines*, 211 B.R. at 431-32 ("in the view of this Court, a rule shifting the burden of proof to the taxing authority in bankruptcy proceedings would render the bankruptcy forum more favorable to taxpayers than the non-bankruptcy forum"); *In re Cobb*, 135 B.R. 640, 641 (Bankr. D. Neb. 1992) ("to rule [in favor of the taxpayer] would permit a tax litigant to shift the burden of proof to the [taxing authority] by filing bankruptcy").

A taxpayer disputing a substantial tax liability would have a strong incentive to file a bankruptcy petition for no other reason than to obtain a favorable forum to litigate the issue. Perhaps even more significantly, a rule shifting the burden of proof to the State in tax disputes (and thus decreasing the State's chances of recovering back taxes from the estate) would create an incentive for non-governmental creditors to initiate involuntary bankruptcy proceedings under 11 U.S.C. § 303.

Alternatively, reallocating the burden of proof would undermine the fairness of the tax system by providing taxpayers "with a windfall merely by reason of the happenstance of bankruptcy." *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 609 (1961). Such a change in the law would "funnel people with tax problems into the bankruptcy courts, and thus undermine the enforcement of state tax law." *Thinking Machines*, 211 B.R. at 431.

A bankruptcy court is not "untethered to any obligation to preserve the coherence of substantive [legislative] judgments." *Noland*, 517 U.S. at 542. Consequently, these courts should not be permitted to

supplant well-established state law in an area of fundamental importance to state sovereignty absent a clear congressional mandate to do so. Because Congress has not sanctioned such wholesale abrogation of state law, Petitioner's position should be rejected.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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March 23, 2000

APPENDIX

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SELECTED STATE LAW GOVERNING BURDEN OF PROOF IN TAX DISPUTES

Alabama: Ala. Code § 40-2A-7(b)(5)(c) (1993) ("On appeal to the circuit court or to the administrative law division, the final assessment [of the taxing authority] shall be prima facie correct, and the burden of proof shall be on the taxpayer to prove the assessment is incorrect.").

Alaska: *Cool Homes v. Fairbanks North Star Borough*, 860 P.2d 1248, 1262-63 (1998) (Alaska 1993) (per curiam) ("Alaska law provides that the taxpayer bears the burden of proof before a Board of Equalization. 'The only grounds for adjustment of the assessment are proof of unequal, excessive, improper or under valuation based on the facts that are stated in a valid, written appeal or proven at the appeal hearing.' AS 29.45.210(b). The Borough Code contains similar language. FNSB 3.24.012(C)(2)."); Alaska Stat. § 43.05.455(c) (1998) (in formal hearings before the Office of Tax Appeals, the "taxpayer bears the burden of proof on questions of fact by a preponderance of the evidence unless a different standard of proof has been set by law for a particular question.").

Arizona: *Graham County v. Graham County Elec. Coop. Inc.*, 512 P.2d 11, 12 (Ariz. 1973) ("A taxpayer in challenging an assessment in the superior court has the burden of proof."); Ariz. Rev. Stat. Ann. § 42-1254(D)(4) (West Supp. 1999) (placing burden of proof on taxing authority in certain limited situations expressly provided for by statute).

Arkansas: *IBM Credit Corp. v. Pulaski County*, 873 S.W.2d 161, 162 (Ark. 1994) ("[t]he burden of

proof [when reviewing tax assessment] is on the protestant assessed.") (citations omitted).

California: *American Airlines, Inc. v. San Mateo*, 912 P.2d 1198, 1210 (Cal. 1996) ("The law generally 'presumes that an assessor has performed [his or her] duty and has assessed all properties fairly and on an equal basis. The taxpayer has the burden of proving otherwise.' ").

Colorado: Colo. Rev. Stat. Ann. § 39-21-105(2)(b) (West 1990) (in appeal of tax determination, "the taxpayer shall have the burden of proof with respect to the issues raised in the notice of appeal except as to the issue of whether the taxpayer has been guilty of fraud with intent to evade tax.").

Connecticut: *Advanced Bus. Sys. v. Crystal*, 650 A.2d 540, 541 (Conn. 1994) (*per curiam*) ("A taxpayer bears the burden of proving the impropriety of an adverse assessment concerning a tax exemption.").

Delaware: Del. Code Ann. tit. 30, § 526(a) (1974) (In any tax proceeding, "the burden of proof shall be on the taxpayer" except in limited circumstances expressly provided for by statute.).

District of Columbia: *Petworth Pharmacy, Inc. v. District of Columbia*, 335 A.2d 256, 258 (D.C. App. 1975) ("In a tax case the petitioner bears the burden of proving the incorrectness of the government's assessment of a deficiency.").

Florida: *Straughn v. Tuck*, 354 So.2d 368, 371 (Fla. 1977) ("Tax assessors are constitutional officers and as such their actions are clothed with the presumption of correctness. One asserting error on the part of the tax assessor must show by 'proof' that every

reasonable hypothesis has been excluded which would support the tax assessor.").

Georgia: *Fowler v. Strickland*, 252 S.E.2d 459, 460 (Ga. 1979) ("The effect of the language of the previously quoted statute is to shift to the taxpayer the burden of going forward with evidence to dispute the correctness of a[] [sales tax] assessment made thereunder.").

Hawaii: *In re EWA Plantation Co.*, 384 P.2d 287, 292 (Haw. 1963) ("taxpayers have the burden to show clearly the invalidity claimed by overcoming the presumption that the tax assessor has faithfully performed his duty.").

Idaho: *Greenfield Village Apts. v. Ada County*, 938 P.2d 1245, 1247 (Idaho 1997) ("The value of property for purposes of taxation determined by an assessor is presumed correct, and the burden of proof is on the taxpayer to show by clear and convincing evidence that the taxpayer is entitled to the relief claimed.").

Illinois: 35 Ill. Comp. Stat. Ann. 200/23-15(b)(2) (West 1993 & Supp. 1999) ("The taxes, assessments, and levies that are the subject of the objection shall be presumed correct and legal, but the presumption is rebuttable. The plaintiff has the burden of proving any contested matter of fact by clear and convincing evidence.").

Indiana: *Scheub v. State Bd. of Tax Comm'rs*, 716 N.E.2d 638, 642 (Ind. Tax. 1999) (taxpayer "bears the burden of demonstrating that the [taxing authority]'s final determination is invalid.").

Iowa: *Boekeloo v. Clinton Bd. of Rev.*, 529 N.W.2d 275, 276-77 (Iowa 1995) ("An appealing property

owner has a twofold burden on appeal. First, the property owner bears the burden to prove that an assessment is excessive. Second, the appealing party 'must establish what the correct valuation should be.' If the property owner 'offers competent evidence by at least two disinterested witnesses that the market value of the property is less than the market value determined by the assessor,' the burden of proof shifts to the board of review to uphold the assessed value.") (citations omitted) (citing Iowa Code § 441.21(1)(a) (1993)); Iowa Code § 421.60(b) (1999) (Except in certain limited circumstances expressly provided for by statute, "the burden of proof shall be on the taxpayer who challenges the assessment or refund denial, except that, with respect to any new matter or affirmative defense, the burden of proof shall be upon the department.").

Kansas: *Ness County Bd. of County Comm'rs v. Bankoff Oil Co.*, 960 P.2d 1279, 1288 (Kan. 1998) ("party challenging the validity of [taxing authority]'s action has the burden of proving it was erroneous").

Kentucky: *Kentucky Rev. Cabinet v. Gillig*, 957 S.W. 2d 206, 209-10 (Ky. 1997) ("While recognizing that the tax assessor's valuation merely reflects an estimation of what the market logically should be, since at least 1932, the law of Kentucky has also granted the estimated property tax assessment a presumption of validity and has placed the burden of establishing that the assessment was incorrect on the taxpayer.").

Louisiana: La. Rev. Stat. Ann. § 13-5034 (West 1991) ("Whenever the pleadings filed on behalf of

the state, or on behalf of any of its officers charged with the duty of collecting any tax, excise, license, interest, penalty, or attorney's fees, shall be accompanied by an affidavit of the officer or of one of his deputies or assistants, or of the counsel or attorney filing the same, that the facts as alleged are true to the best of the affiant's knowledge or belief, all of the facts alleged in the pleadings shall be accepted as prima facie true and as constituting a prima facie case, and the burden of proof to establish anything to the contrary shall rest wholly on the defendant or opposing party.").

Maine: *Chase v. Machiasport*, 721 A.2d 636, 640 (Me. 1998) ("A taxpayer seeking an abatement from the County Commissioners has the burden of proving that the assessed valuation is 'manifestly wrong.'"); Me. Rev. Stat. Ann. tit. 36, § 1763 (West 1990) ("The burden of proving that a transaction was not taxable shall be upon the person charged with tax liability.").

Maryland: Md. Code Ann., Tax-Gen. § 11-103(b) (1997) ("The person required to pay the sales and use tax has the burden of proving that a sale in the State is not subject to the sales and use tax.").

Massachusetts: Mass. Gen. Laws Ann. ch. 64H, § 8(a) (West 1998 & Supp. 1999) (presumption that all sales are taxable; "[t]he burden of proving that a sale of services or tangible personal property by any vendor is not a sale at retail shall be upon such vendor").

Michigan: *Elias Bros. Rest., Inc. v. Treasury Dep't*, 549 N.W.2d 837, 840 (Mich. 1996) ("Because tax exemptions are disfavored, the burden of proving

entitlement to an exemption rests on [the taxpayer], the party asserting the right to the exemption.").

Minnesota: *Minnesota Twins Partnership v. Commissioner of Rev.*, 587 N.W.2d 287, 289 (Minn. 1998) ("Tax assessments by the commissioner 'are presumed to be valid and correctly determined' and the burden of showing that the assessment is invalid lies with the taxpayer.") (citing Minn. Stat. § 270.68(3) (1998)).

Mississippi: *City of Cleveland v. T.V. Cable Co.*, 121 So.2d 862, 863 (Miss. 1960) (in tax assessment dispute, "the burden is upon the taxpayer to show by two or more competent witnesses who know of their own personal knowledge that the property is assessed for a higher sum than its true value.").

Missouri: *Westwood Country Club v. Director of Rev.*, 6 S.W.3d 885, 887 (Mo. Supp. 2000) ("Exemptions from taxation are to be strictly construed, and, as such, it is the burden of the taxpayer claiming the exemption to show that it fits the statutory language exactly.") (citations omitted); Mo. Ann. Stat. § 136.300 (West Supp. 2000) ("The director of revenue shall have the burden of proof with respect to any factual issue relevant to ascertaining the liability of a taxpayer" in certain limited circumstances expressly provided for by statute.).

Montana: *Farmers Union Central Exch., Inc. v. Dep't of Rev. of Montana*, 901 P.2d 561, 564 (Mont. 1995) (at tax dispute hearing, "[taxpayer] bore the burden of proving that the [Department of Revenue]'s classification was incorrect.").

Nebraska: Neb. Rev. Stat. § 77-2781 (1995) ("In any proceeding before the Tax Commissioner, the burden

of proof shall be on the taxpayer" except in limited circumstances as expressly provided for by statute.).

Nevada: Nev. Rev. Stat. § 372.155 (1986) ("For the purpose of the proper administration of this chapter and to prevent evasion of the sales tax it is presumed that all gross receipts are subject to the tax until the contrary is established. The burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless he takes from the purchaser a certificate to the effect that the property is purchased for resale.").

New Hampshire: *Public Serv. Co. of New Hampshire v. Town of Ashland*, 377 A.2d 124, 127 (N.H. 1977) (in property tax assessment dispute, "[t]he taxpayer has the burden of proof and it is the taxpayer's responsibility to satisfy the board as to the disproportionality of the tax burden imposed by the selectmen.").

New Jersey: *Seventeen Thirty Corp. v. Director, New Jersey Div. of Tax.*, 18 N.J. Tax 168, 179 (N.J. Tax Ct. 1999) ("The determination by [the taxing authority] that additional Corporation Business Tax payments are due from [plaintiff taxpayer corporation] is entitled to a presumption of correctness. Plaintiff bears the initial burden of overcoming this presumption, and, if it does so, it then has the burden of proof that the assessment of taxes was incorrect.").

New Mexico: *Brim Healthcare, Inc. v. New Mexico Tax. & Rev. Dep't*, 896 P.2d 498, 500 (N.M. Ct. App. 1995) ("Where the taxpayer claims an exemption from the gross receipts tax, the exemption must be unambiguously expressed in the statute and clearly established by the taxpayer. The taxpayer

therefore has the burden of overcoming the statutory presumption that all receipts of a person engaging in business are subject to the gross receipts tax.") (citations omitted).

New York: *Grace v. New York Tax Comm'n*, 332 N.E.2d 886, 888 (N.Y. 1975) ("The burden of proof to overcome tax assessments rests upon the taxpayer.").

North Carolina: *Albemarle Elec. Membership Corp. v. Alexander*, 192 S.E.2d 811, 816 (N.C. 1972) ("The members of the State Board of Assessment are public officers, and the Board's official acts are presumed to be made in good faith and in accordance with law. The burden is upon the party asserting otherwise to overcome such presumptions by competent evidence to the contrary. Every reasonable intendment will be made in support of these presumptions.").

North Dakota: *Trollwood Village Ltd. Partnership v. Cass County Bd. of County Comm'rs*, 557 N.W.2d 732, 736 (N.D. 1996) (in tax assessment dispute, "the [taxpayer] carries the burden on appeal of showing error.").

Ohio: *Maxxim Med., Inc. v. Tracy*, 720 N.E.2d 911, 913 (Ohio 1999) (" 'when an assessment is contested, the taxpayer has the burden . . . to show in what manner and to what extent . . . the commissioner's investigation and audit, and the findings and assessments based thereon, were faulty and incorrect.' The Tax Commissioner's findings are presumptively valid, absent a demonstration that those findings are clearly unreasonable or unlawful.").

Oklahoma: Okla. Stat. tit. 68, § 1365(C) (1992) (In sales tax disputes, the "burden of proving that a sale

was not a taxable sale shall be upon the person who made the sale.").

Oregon: Or. Rev. Stat. § 305.427 (1997) (in all tax proceedings, "[t]he burden of proof shall fall upon the party seeking affirmative relief").

Pennsylvania: 72 Pa. Cons. Stat. Ann. § 3402-505 (West 1995) ("In all cases of petitions for reassessment and appeals, the burden of proof shall be on the petitioner or appellant").

Rhode Island: *Rhode Island Lithograph Corp. v. Clark*, 519 A.2d 589, 591 (R.I. 1987) ("It is a settled rule in this jurisdiction that tax-exemption statutes are construed against the taxpayer and further that the taxpayer must discharge the burden of proof in establishing by competent evidence that it is entitled to an exemption.").

South Carolina: *South Carolina Tax Comm'n v. South Carolina Tax Bd. of Rev.*, 299 S.E.2d 489, 492-93 (S.C. 1983) (in tax assessment dispute, taxpayers "have the burden to overcome the presumption that the valuation is correct.").

South Dakota: *Fall River County v. South Dakota Dep't of Rev.*, 601 N.W.2d 816, 823 (S.D. 1999) ("In challenging a tax assessment ruling, the challenger has two presumptions to overcome: 'First, there is a presumption that tax officials will do their duty in accordance with the law and not act unfairly and arbitrarily regarding the assessment of property. Second, there is a presumption that [Department of Revenue]'s valuations are correct.' ").

Tennessee: *Howard v. United States*, 566 S.W.2d 521, 528 (Tenn. 1978) ("There is a presumption that tax

assessments are valid and the burden is on the taxpayer to prove that they are erroneous.").

Texas: *Bullock v. National Bancshares Corp.*, 584 S.W.2d 268, 272 (Tex. 1979) (in claim for exemption from franchise tax, "the burden of proof is on the claimant to clearly show that it comes within the statutory exemption.").

Utah: Utah Code Ann. § 59-10-543 (1996) ("In any proceeding before the [tax] commission . . . the burden of proof shall be upon the petitioner" except in certain limited circumstances expressly provided for by statute.).

Vermont: Vt. Stat. Ann. tit. 32, § 5291 (1994) (when taxpayer disputes validity of tax appraisal, "the burden of proof shall be on the plaintiff in so far as the validity of such tax is thus put in issue.").

Virginia: *Winchester & Western R.R. Co. v. State Corp. Comm'n*, 374 S.E.2d 66, 68 (Va. 1988) (On tax assessment appeal, "the burden is on the taxpayer to prove that the assessment is erroneous.").

Washington: *In re Sehome Park Care Ctr., Inc.*, 903 P.2d 443, 445 (Wash. 1995) (en banc) ("A tax exemption presupposes a taxable status and the burden is on the taxpayer to establish eligibility for the benefit.").

West Virginia: *Appalachian Power Co. v. West Virginia Tax Dep't*, 466 S.E.2d 424, 444 (W. Va. 1995) ("It is universally recognized that taxpayers have the burden to prove the Tax Commissioner's determination is not correct.") (citing *Welch v. Helvering*, 290 U.S. 111 (1933)).

Wisconsin: Wis. Stat. Ann. § 70.109 (West 1999) (property tax exemptions "shall be strictly construed in every instance with a presumption that the property in question is taxable, and the burden of proof is on the person who claims the exemption.").

Wyoming: *Amoco Prod. Co. v. Wyoming State Bd. of Equalization*, 899 P.2d 855, 858 (Wyo. 1995) (in tax valuation dispute, " 'The burden of proof is upon the party asserting an improper valuation.' ") (citations omitted).

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In The

Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee for Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF *AMICI CURIAE* FOR THE STATES OF NEW MEXICO, ARIZONA, CALIFORNIA, COLORADO, CONNECTICUT, DELAWARE, FLORIDA, IOWA, KANSAS, LOUISIANA, MAINE, MARYLAND, MASSACHUSETTS, MICHIGAN, MINNESOTA, MISSOURI, MONTANA, NEBRASKA, NEVADA, NEW JERSEY, NORTH DAKOTA, OHIO, OREGON, PENNSYLVANIA, RHODE ISLAND, SOUTH DAKOTA, TENNESSEE, UTAH, VERMONT, WASHINGTON AND WYOMING IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICI CURIAE*

One of the primary law enforcement responsibilities of state government is ensuring that citizens comply with state tax laws. The *amici* states have a vital interest in this case. The decision below must be affirmed in order to ensure that the bankruptcy court does not become a master state and federal tax court. If the burdens of proof are more favorable in bankruptcy court than in state tribunals, the result will significantly, unfairly and erroneously hamper the enforcement of state tax laws. Simply stated, the bankruptcy courts could become a tax haven.

At issue is whether a taxpayer who has the burden of proof under state law can shift the burden to the government by filing for bankruptcy. The bankruptcy court's consideration of the validity of a tax claim is not a rare or unusual situation. Slightly more than 1.3 million bankruptcies were filed in calendar year 1999 in the United States. Nearly 400,000 of those cases were Chapter 13 or Chapter 11 cases where the debtors/taxpayers were the real parties in interest.[1] The vast majority of the remaining cases were "no-asset" Chapter 7 cases, in which little, if any, litigation took place.[2] The remaining minority, the "asset" cases, involved a Chapter 7 trustee administering and distributing those assets. An enormous amount of tax

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[1] 1,319,465 bankruptcy petitions were filed in calendar year 1999. Of those, 382,214 were Chapter 13 cases and 9,315 were Chapter 11 cases. *See News Release*, Administrative Office of the U.S. Courts, March 3, 2000, reprinted at http://www.uscourts.gov/Press___Releases/cy99bk.pdf. Although the total numbers have declined somewhat since the record high filing levels of over 1.4 million cases in 1998, Chapter 11's have actually increased and the decline in Chapter 13's has been slight. *Id.*

[2] *See* Administrative Office of the U.S. Courts' Publication entitled *Bankruptcy Basics* at 3 and 14, reprinted at http://www.uscourts.gov/bankbasic.pdf.

revenues are subject to the review and control of the bankruptcy courts.[3]

On several occasions, this Court has noted that burden of proof is an issue of substantive law. It will often determine the prevailing party in a legal proceeding. In the tax context, a rule of requiring the taxpayer to bear the burden of proof is essential and promotes the policies of tax administration. The alternative of requiring the government to disprove a claimed deduction of the taxpayer, for instance, would not only be impractical, it would seriously undermine the companion laws requiring taxpayers to keep adequate documentation. Moreover, the government's relative lack of knowledge of the particulars of the taxpayer's financial affairs makes placing the burden of proof on the taxpayer necessary and fair. Placing the burden of proof on the government in bankruptcy cases will promote forum shopping, reward irresponsibility, and increase the burden on other taxpayers because of the loss of tax revenue.

SUMMARY OF ARGUMENT

1.) There has never been an established bankruptcy policy assigning uniform burdens of proof, as the petitioner argues, nor should there be. In fact, the majority of cases under the Bankruptcy Act properly applied nonbankruptcy law burdens of proof when addressing an objection to a tax claim.

2.) The Seventh Circuit's decision below to apply the state law burden of proof to Illinois' tax claim is consistent with both federal statutory and common law and with this Court's decisions. *See* 28 U.S.C. § 1652 (state

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[3] Francis M. Allegra, *Bankruptcy Courts: The Tax Forum for the '90s* 38 FED. BAR NEWS AND J. 338 (August 1991) (reporting that in 1991, the nine largest bankruptcy tax claims totaled $9.6 billion in federal taxes).

law provides the "rules of decision in civil actions" in which state law is decided in federal court); *Butner v. United States*, 440 U.S. 48 (1979) (unless Congress specifically states otherwise, the basic rule in bankruptcy is that state law determines the substantive rights of the parties). The court below correctly determined that in a bankruptcy proceeding the party seeking to refute the tax assessment has the ultimate burden of proving its claim. The court succinctly stated that "bankruptcy is not a 'free-for-all balancing act.'" *In re Stoecker*, 179 F.3d 546, 551 (7th Cir. 1999) (citation omitted).

3.) Bankruptcy courts hear a wide range of issues, especially at the claim objection stage. Because bankruptcy courts often are the forum for litigating purely state-law issues, issues which do not implicate any provision of the bankruptcy code, the *Erie* doctrine should be clearly applicable in bankruptcy when such nonbankruptcy issues are addressed.

4.) A review of cases indicates that only as against the government have some courts been attempting to fashion a "uniform" rule. In other contexts, when nonbankruptcy law requires varying burdens or standards of proof, other than the ordinary plaintiff-carries-the-burden rubric, the courts have perceived no conflict with bankruptcy policy and applied nonbankruptcy law. The so-called uniform rule has never been uniformly applied, and in fact, has been discriminatorily applied. A truly "uniform" policy regarding burdens of proof when litigating nonbankruptcy law in bankruptcy court would make no sense.

5.) If the opinion below is not affirmed, the bankruptcy courts could become the tax court of choice for both state and federal tax disputes. The petitioner asserts that when a claim objection is filed, the dispute ceases being one between the taxpayer and the government and instead becomes one between the government and the

taxpayers' creditors. This is not the *amici* states' experience. Although the dispute here is between the state of Illinois and a chapter 7 bankruptcy trustee for the creditors, most tax litigation in bankruptcy court involves direct disputes between the government and the taxpayers. Whatever rule the Court crafts will presumably apply in other cases as well. The petitioner seeks a result which will "funnel people with tax problems into the bankruptcy courts, and thus undermine the enforcement of state tax law." *Thinking Machines v. New Mexico Tax. and Rev. Dept.*, 211 B.R. 426, 431 (D. Mass. 1997). Firmly established federal policy indicates a reluctance to interfere with state tax laws, and indicates that reorganizing businesses should not have a competitive advantage with regard to tax liability. Moreover, the decision below is in harmony with Congress' intent that tax claims be paid as shown by the priority and exception from discharge afforded those claims.

ARGUMENT

I. THERE HAS NEVER BEEN A BANKRUPTCY POLICY REGARDING UNIFORM BURDENS OF PROOF IN THE CLAIM OBJECTION PROCESS.

Confusion has arisen over the effect of Rule 3001(f), of the Federal Rules Bankruptcy Procedure, which states that "[a] proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." Some courts have construed this *initial* prima facie effect of claims as containing a negative implication that the *ultimate* burden of proof is *always* on every creditor. *In re Fidelity Holding Co.*, 837 F.2d 696 (5th Cir. 1988). No such result was intended. Rule 3001(f) is merely an adaptation of *Whitney v. Dresser*, 200 U.S. 532 (1906), *aff'g In re Dresser*, 135 F. 495 (2d Cir. 1905).

In *Whitney v. Dresser* the trustee had objected to a proof of claim seeking payment on a debt for moneys loaned, alleging that the obligation was not owed by the company but, rather, by its principal. After the trustee's testimony, the referee granted the creditor's motion to strike the trustee's objection to the proof of claim and allowed the claim without the creditor having to put on his case. *In re Dresser*, 135 F. 495, 497. The following issue was ultimately put before this Court: Does a proof of claim have some prima facie evidentiary validity which must be overcome by an objector, as an initial matter, or rather, does the trustee have the rights of a defendant in a civil lawsuit which require the claimant to prove up the case whenever the debt is merely denied? *Whitney v. Dresser*, 200 U.S. at 534-35. In *Dresser*, the Court of Appeals stated that if "a proof of claim in bankruptcy [were] entitled to no greater weight than a complaint in an ordinary action at law the most serious results will follow. Any vindictive or contumacious creditor can, by filing objections, compel creditors to come from distant states and even from foreign countries to testify in support of their claims before a word of testimony impeaching their validity has been adduced." 135 F. at 498.

This Court affirmed the Court of Appeals and ruled that a proof of claim has some probative force that must be met with evidence. *Whitney v. Dresser*, 200 U.S. at 534-535. Justice Holmes succinctly identified the issue that is presently before the Court and distinguished that issue from the evidentiary weight to be given a sworn proof of claim: "It is not a question of the burden of proof in a technical sense – *a burden which does not change, whatever the state of the evidence* – but simply whether the sworn proof is evidence at all." *Id.* (emphasis added).

In 1938, Congress amended § 57n of the National Bankruptcy Act of 1898 (hereafter the Act) to require that government claims be "proved and filed in the manner provided in this section," as the petitioner correctly

states. Brief of Petitioner 11; 52 Stat. 840, 867 (1938). Petitioner implies, however, that this statutory change indicated a congressional intent to affect the burdens of persuasion. Brief of Petitioner 8. But the petitioner misconstrues the simple reason for this change. "The provision in respect to government claims is added in order to overcome the decisions which hold that the bar time for filing claims is not binding on the sovereign." H.R. Rep. No. 1409, 75th Cong., 1st Sess. at 13 (1937). The term "prove" was not defined in the Act, but when used in legal matters and proceedings it is understood to mean "to establish, to render or make certain." Black's Law Dictionary 1224 (6th ed. 1990). Nothing in the history of the amendment to § 57n indicates that it had anything whatever to do with allocating burdens of persuasion. The obvious intent of the requirement that government claims be "proved and filed" on time was merely that a *proof* of claim be *filed* timely.[4] "Redundancies across statutes are not unusual events in drafting. . . . " *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 253 (1992). Although the terminology "proof of claim" has been retained in the Bankruptcy Code, the Code no longer refers to claims being "proved."

Prior to 1960, section 57a of the Act (11 U.S.C. § 93a), provided that proofs of claim consisted of, among other things, "a statement under oath, in writing, and setting forth the claim." 52 Stat. 840, 866 (1938). In a 1960 amendment to § 57a of the Bankruptcy Act, Congress removed the requirement that proofs of claim be under oath, while, at the same time, codifying the "prima facie evidence" effect of a proof of claim originally announced in *Whitney*

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[4] At the time, courts equated "proving" a claim with filing a claim which complied with the statutory requirements. *Burton Coal Co. v. Franklin Coal Co.*, 67 F.2d 796, 800 (8th Cir. 1933); *In re Noble*, 15 F. Supp. 648 (W.D.N.Y. 1936).

v. Dresser, 200 U.S. at 535-36. From 1960 until the Bankruptcy Code became law in 1979, the last sentence of § 57a of the Act read: "A proof of claim filed in accordance with the requirements of the Bankruptcy Act, the General Orders of the Supreme Court, and the official forms, even though not verified under oath, shall constitute prima facie evidence of the validity and amount of the claim." Pub. L. No. 86-519, 74 Stat. 217 (1960). Merely removing the requirement that claims be under oath does not evidence any intent to expand *Whitney v. Dresser's* singular, manifest rule that proofs of claim constitute prima facie evidence.

In the early 1970's, a concerted effort to arrive at comprehensive procedural bankruptcy rules was made and Bankruptcy Rule 301 was adopted. Subsection (b) of that rule stated that "[a] proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." According to the 1971 Advisory Committee's Note, the rule was an "adaptation of section 57a of the Act." No statute similar to § 57a of the Act was provided in the Bankruptcy Code when enacted, although Rule 301 continued to apply under the Code until 1983. The Rules were substantially revised again in 1983 and the provisions of Rules 301 and 302 were combined into Rule 3001.[5] Rule 3001(f) used the precise language as former Rule 301(b) and very similar language to § 57a of the Act. Fed. R. Bankr. P. 3001(f).

From this discussion two things are apparent: (1) Nothing in Rule 3001(f), or its predecessors, indicates an intention to alter the underlying substantive laws regarding burdens of proof, and (2) the Rule was derived from

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[5] The format was changed from three-digit to the current four-digit format, among other changes. In 1991, the official citation of the Bankruptcy Rules was changed to Federal Rules of Bankruptcy Procedure. Fed. R. Bankr. P. 1001.

Whitney v. Dresser's intent *to protect creditors* against having to travel "from distant states and even from foreign countries" to defend against unsupported claim objections. *In re Dresser*, 135 F. at 498; Fed. R. Bankr. P. 3001(f). The modest protection for creditors provided by *Whitney v. Dresser* and the subsequent statutory and regulatory adaptations cannot be read as assigning the ultimate burden of proof to creditors who were not otherwise required to bear those evidentiary burdens. As Justice Holmes stated, "[i]t is not a question of the burden of proof . . . which does not change. . . . " 200 U.S. at 534-35.

Most cases involving the issue of the ultimate burden of proof in regard to tax claims decided under the Bankruptcy Act appear to have apprehended the singular significance of *Whitney v. Dresser* in attaching evidentiary value to a proof of claim, the similar effect of both the corresponding amendment of § 57a of the Act, in 1960, and the adoption of Rule 301(b), in 1971. The clear majority of Act cases ruled that the ultimate burden of proof did not shift to the government when a tax claim was litigated in bankruptcy court. Although the petitioner cites contrary authority, the more numerous cases supporting the respondent are set out in the margin.[6] The

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[6] *See, e.g., In re Uneco, Inc.*, 532 F.2d 1204 (8th Cir. 1976) (trustee had burden of proving bad debt deduction in dispute with IRS); *Paschal v. Blieden*, 127 F.2d 398 (8th Cir. 1942) (burden of proof was on trustee to prove assessment incorrect); *In re Lang Body Co.*, 92 F.2d 338, 341 (6th Cir. 1937), *cert. denied sub nom. Hipp v. Boyle*, 303 U.S. 637 (citing nonbankruptcy law, court ruled that trustee had burden of proving that property taxes were arbitrary; standard of proof was clear and convincing evidence); *United States v. Knox Powell Stockton, Co.*, 83 F.2d. 423 (9th Cir. 1936); *In re Canady*, 43 A.F.T.R. 2d 79-472 (N.D. Ga. 1978) (nonbankruptcy burden of proof applies in objection to tax claim); *In re Menefee*, 40 A.F.T.R. 2d 77-5006, 5013 (E.D. Mo. 1977) (bankrupt had burden of proof on IRS counterclaim to

divided case authority under the Act, coupled with the fact that the Code does not address the issue, establishes,

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action initiated by bankrupt); *In re Certified Credit Corp.*, 329 F. Supp. 1402 (S.D. Ohio 1971) (presumption of correctness of IRS assessment continued in bankruptcy; trustee had the burden of proving deductions; taxing authorities' entitlement to nonbankruptcy burden of proof is no different than any other creditor's right to require that the debtor prove certain defenses or setoffs); *In re Standard Mill*, 324 F. Supp. 386, 390 (N.D. Tex. 1970) (trustee had burden to prove that property tax valuation was grossly exaggerated under Texas law); *In re Reeves*, 25 A.F.T.R. 2d 70-761, 764 (D. Colo. 1970) (objecting party has burden of proof when tax claim is objected to in bankruptcy court); *In re Parr*, 205 F. Supp. 492, 497 (S.D. Tex. 1962) (adopting Internal Revenue Code burdens of proof, trustee had burden of proof of overcoming assessment if no fraud is claimed; IRS has burden on fraud); *In re Oxford Ass'n*, 10 A.F.T.R. 2d 5957 (D.N.J. 1962); *In re Ward*, 131 F. Supp. 387 (D. Colo. 1955) (objecting party had burden of proof on objection to tax claim); *In re Petersilge*, 70 F. Supp. 95, 96 (N.D. Ohio 1946) (adopted Ohio law regarding burden of proof for overcoming sales tax assessment); *In re Garfield Bag & Stationery Co.*, 42 F. Supp. 708, 711 (S.D.N.Y. 1941) (trustee had burden of proving deductions in city's business and sales taxes); *In re Glotzer*, 42 F. Supp 712 (S.D.N.Y. 1941); *In re Raflowitz*, 37 F. Supp. 202, 207 (D. Conn. 1941) (presumption of correctness of tax assessment continues in bankruptcy); *In re Lasky*, 38 F. Supp. 24, 30 (N.D. Ala. 1941) (burden of proof on trustee to overcome property tax assessments); *In re Gandolfi & Co.*, 42 F. Supp. 706 (S.D.N.Y. 1940); *In re Trustees System Co. of Louisville*, 30 F. Supp. 361 (W.D. Ky. 1939); *In re Mid America Co.*, 31 F. Supp. 601, 606-07 (N.D. Ill. 1939) (trustee had burden under Illinois law of disproving issue regarding employment taxes); *In re Bell*, 34 F.2d 677, 680 (D. Pa. 1929) (trustee had burden of proof on IRS deduction), *modified*, 39 F.2d 361 (3d Cir. 1930); *In re Glover-McConnell Co.*, 9 F.2d 683 (D. Ga. 1925); *In re Shackelford*, 3 B.R. 42 (Bankr. W.D. Mo. 1980) (in an action designated as discharge complaint by bankrupt, but was in effect action seeking to determine that bankrupt owed no taxes, bankrupt had burden of proof); *In re Osborn*, 4

at best, that there was never an accepted understanding regarding taxing authorities and the ultimate burden of proof in bankruptcy. In commenting on the similar development of the law regarding certain creditors' ability to obtain relief from the stay to foreclose on their collateral, the Court noted that "[t]he at best divided authority under [the Act] removes all cause for wonder that the alleged departure from it should not have been commented upon in the legislative history." *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 381-82 (1988).

II. THE COURT SHOULD AFFIRM BASED ON THE UNDERLYING PRINCIPLES OF *BUTNER v. UNITED STATES*, 440 U.S. 48 (1979) AND 28 U.S.C. § 1652.

The Bankruptcy Code does not address the issue of burden of proof when claims are litigated in bankruptcy court. In the most general terms possible, Congress has stated only that, "if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency. . . . " Bankruptcy Code § 502(b). Similarly, § 505(a)(1) permits the court to "determine the amount or legality of any tax. . . . " Bankruptcy courts are units of the district courts. 28 U.S.C. § 151. The Federal Rules of Evidence apply in the bankruptcy courts. Fed. R. Evid. 101.

Where an issue of state law is to be determined in federal court, the rules for making the decision are provided by state law. 28 U.S.C. § 1652. The traditional and

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B.R. 431 (Bankr. W.D. Mo. 1979) (bankrupt had burden of proof on IRS counterclaim asking for judgment for taxes owed); *In re O'Neill*, 80-2 U.S.T.C. (CCH) ¶ 9716 (Bankr. W.D. Va. 1980) (in action brought jointly by bankrupt and trustee to declare that no taxes were owed, bankrupt and trustee had burden of proof).

well recognized rule of tax law is that the ultimate burden of persuasion is placed on the taxpayer. *E.g., Stohr v. New Mexico Bureau of Revenue*, 90 N.M. 43, 559 P.2d 420 (Ct. App. 1976).[7] Rule of Evidence 301 provides that the ultimate burden of persuasion "remains throughout the trial upon the party on whom it was originally cast." Fed. R. Evid. 301. Rule 302 provides that the effect of any presumption arising under state law is to be determined by state law. Fed. R. Evid. 302.

A fundamental principle of bankruptcy law was succinctly stated in *Butner v. United States*, 440 U.S. 48 (1979). "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 55. The Court noted that the "basic rule" in bankruptcy proceedings "is that state law governs." *Id.* at 57. "The validity of a creditor's claim is determined by the rules of state law." *Grogan v. Garner*, 498 U.S. 279, 283 (1991) (referring to standards of proof).

As this Court has noted time and time again in diversity cases, burdens of proof are part of the substantive law of the state. *E.g., Dick v. New York Life Ins. Co.*, 359

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[7] A compilation of every state's rules would reveal that there are variations among the states. *See, e.g.*, Ariz. Rev. Stat. §§ 42-1254-D-4 (1999) (appearing to adopt rules similar to I.R.C. § 7491). Although it would appear that the traditional rule that the taxpayer has the burden of persuasion applies in most instances – *e.g., James v. Huddleston*, 795 S.W.2d 661, 663 (Tenn. 1990); *Baker v. Bullock*, 529 S.W.2d 279 (Tex. App. 1975); *Hawes v. LeCraw*, 121 Ga. App. 532, 174 S.E.2d 382 (1970) – attempting to impose a "uniform" rule in bankruptcy court would make the application of state tax law in each state unpredictable, and anything but uniform. In fact, such a uniform bankruptcy rule would, in some manner, conflict with every states' tax laws. See Appendix, Br. Am. Cur. Council of State Governments et al.

U.S. 437 (1959); *Palmer v. Hoffman*, 318 U.S. 109 (1943); *Cities Service Oil Co. v. Dunlap*, 308 U.S. 208 (1939). Consistent with those cases, this Court has ruled that when a federal claim is tried in state court, the state court must apply the federal law burden of proof, noting it "was a part of the very substance of his claim and cannot be considered a mere incident of procedure." *Garrett v. Moore-McCormack Co.*, 317 U.S. 239, 248-49 (1942). *See Director, Office of Workers' Compensation Programs, Dept. of Labor v. Greenwich Collieries*, 512 U.S. 267, 271 (1994) (assignment of burden of proof to the claimant under § 7(c) of APA is statutory, and part of the "substantive law" which cannot be overridden by agency regulation; "true doubt" regulation, which shifted the risk of non-persuasion to the employers in Black Lung Benefits and Longshore and Harbor Workers Compensation Act proceedings, held to be invalid).

Whether a liability exists is often determined by which party has the burden of establishing certain claims or defenses, a principal reason why that burden is "a part of the very substance of [the] claim." *Garrett*, 317 U.S. at 249. This Court should not give debtors "a windfall merely by reason of the happenstance of bankruptcy." *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 609 (1961).

III. *ERIE v. TOMPKINS*, 304 U.S. 64 (1938) APPLIES IN BANKRUPTCY COURT WHEN PURELY STATE LAW ISSUES ARE BEING LITIGATED IN THE FEDERAL FORUM.

The petitioner argues that *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938) does not apply in bankruptcy, Brief of Petitioner at 22, and, instead, that the Court should allocate the burden of proof "in a manner that is consistent with federal policies underlying the Code." Brief of Petitioner at 26. Because *Erie v. Tompkins, supra*, construed the predecessor statute of the Rules of Decision Act, 28 U.S.C.

§ 1652 (state law provides the "rules of decision in civil actions" in which state law is decided in federal court), the petitioner implicitly argues that the Rules of Decision Act does not apply in bankruptcy either. The petitioner's position is erroneous and misses the point.

In many instances, like district courts hearing diversity of jurisdiction cases, bankruptcy courts are the forums in which rights which arise solely from state law are litigated. *See* Paul J. Mishkin, *Federal "Question" in the District Courts*, 53 COLUM. L. REV. 157, 184-196 (1953) (discussing how certain cases are properly in federal court because they protect a certain federal interest rather than enabling enforcement of a federal law, where purely state law is being addressed; the examples he used were diversity cases, cases involving federally chartered corporations, and suits brought by bankruptcy trustees to acquire moneys owed to the debtor under state law). The *Erie* doctrine is not limited to *diversity* jurisdiction, but applies in all cases of *protective* jurisdiction – cases where the courts are not "vindicating any federally created rights" but where the federal forum is providing for "the protection of some congressionally favored interest." *Hollus v. Amtrak Northeast Corridor*, 937 F. Supp. 1110, 1113 n.3 (D.N.J. 1996) (quoting Mishkin, *supra*, and applying *Erie* in lawsuit brought in federal court pursuant to statute granting jurisdiction in cases where the federal government owned a majority of the shares of one of the corporate parties). "Typically, the purpose of the[ ] federal [bankruptcy] rules has been to accommodate state laws in the compressed process in which assets of the bankrupt are gathered together and distributed to creditors. Whether Congress could dictate the rules of decision in trustees' suits simply because it preferred certain commercial law doctrines over contrary state rules has not been tested in the courts." Carol E. Goldberg-Ambrose,

The Protective Jurisdiction of the Federal Courts, 30 UCLA L. REV. 542, 581 (1983).[8]

The bankruptcy jurisdiction statute, 28 U.S.C. § 1334, is different than the general federal question statute, 28 U.S.C. § 1331. There are three components to the bankruptcy jurisdiction statute. Section 1334(a) provides that certain proceedings are exclusively within federal jurisdiction. Section 1334(b) addresses proceedings where jurisdiction is non-exclusive. The current bankruptcy abstention statute, 28 U.S.C. § 1334(c), recognizes that bankruptcy courts hear state law disputes in federal court only because a debtor filed a bankruptcy petition. Granted, federal courts are not *always* required to use "state law to fill the gaps in federal substantive statutes." *DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151, 159 n.13 (1983) (construing whether to adopt a state statute of limitations in lawsuit brought pursuant to a federal statute with no state law equivalent). That is hardly what is happening here. No federal statute provides the basis of liability. "[I]t is the *source* of the right sued upon, and not the ground on which federal jurisdiction over the case is founded, which determines the governing law." *Maternally Yours v. Your Maternity Shop*, 234 F.2d 538, 540 n.1 (2d Cir. 1956). The source of the liability is the Illinois legislature. The Illinois tax debt is by no means an "interstitial . . . detail," *DelCostello, supra*, of the bankruptcy code.[9]

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[8] Ms. Goldberg-Ambrose's article was cited with approval in *Gutierrez de Martinez v. Lamagno*, 515 U.S. 417, 436 n.11 (1995).

[9] Even in areas that could be designated as a "gap" in federal law, the Court has shown a preference to adopt state law. *See O'Melveny & Meyers v. F.D.I.C.*, 512 U.S. 79, 83-87 (1994) (citing *Erie v. Tompkins* in a lawsuit brought by the FDIC, and refusing to supplement the federal scheme with a common law rule which would displace state law). The bankruptcy court is the forum. The Illinois' tax law provides the obligation and, moreover, Illinois is the obligee. There is simply no "gap" to fill. "To create additional 'federal common-law' exceptions is not to 'supplement' this scheme, but to alter it." *Id.* At 87.

The nature of bankruptcy proceedings makes the conclusion that the *Erie* doctrine applies in bankruptcy inescapable. For instance, in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), this Court struck down the initial jurisdictional scheme accompanying the Bankruptcy Code because the non-Article III bankruptcy courts were authorized to hear state law contract actions without any supervision by the Article III courts. Claim objection proceedings are discrete "contested matters" which are brought pursuant to Federal Rules of Bankruptcy Procedure 3007 and 9014; Rule 9014 incorporates most of the Federal Rules of Civil Procedure, or their bankruptcy equivalents. Claim objection proceedings are obviously "civil actions" seeking to establish or negate liabilities which will generally be derived from state law. "The fact that a suit arises under a law of the United States does not mean that all the issues for decision are federal issues; and nowhere is this more true than in bankruptcy." Hill, *Erie Doctrine in Bankruptcy*, *infra*, at 1034. Nothing in the Rules of Decision Act limits its application to diversity cases. *Morgan v. South Bend Community School Corp.*, 797 F.2d 471, 474-75 (7th Cir. 1986).

The power to administer her tax laws is one of the more important attributes of Illinois' sovereignty. There could hardly be a scenario where the *Erie v. Tompkins* concerns are more applicable:

> [T]he mischievous results of the doctrine [of federal general law] had become apparent. . . . It made rights enjoyed under the unwritten "general law" vary according to whether enforcement was sought in the state or in the federal court; and the privilege of selecting the court in

> which the right should be determined was conferred upon the noncitizen. Thus, the doctrine rendered impossible equal protection of the law. In attempting to promote uniformity of law throughout the United States, the doctrine had prevented uniformity in the administration of the law of the state.
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> . . . .
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> "But law in the sense in which courts speak of it today does not exist without some definite authority behind it. The common law so far as it is enforced in a State, whether called common law or not, is not the common law generally but the law of that State existing by the authority of that State. . . . "

Erie R. Co. v. Tompkins, 304 U.S. 64, 74-79 (1938) (citations omitted) (quoting *Black & White Taxicab & Transfer Co. v. Brown & Yellow Taxicab & Transfer Co.*, 276 U.S. 518, 533 (1928) (Holmes, J. dissenting)).

The *Erie* doctrine was properly applied in bankruptcy matters by the Courts of Appeals in such cases as *In re Madeline Marie Nursing Homes*, 694 F.2d 433, 437 (6th Cir. 1982) (the court reasoned that the *Vanston* doctrine, *infra*, has "never been applied, . . . to oust state law in the original determination of the existence and amount of liability"), and *In re Transystems, Inc.*, 569 F.2d 1364, 1366 (5th Cir. 1978) (whether a party was a secured creditor or equity holder was solely a matter of state law under the *Erie* doctrine). *See Coastal Steel Corp. v. Tilghman Wheelabrator, Ltd.*, 709 F.2d 190, 201 (3d Cir. 1983) (bankruptcy clause enables convenient federal forum to hear a state-created obligations case but does not federalize those relationships); 19 C. Wright, A. Miller & C. Cooper, Federal Practice and Procedure: Jurisdiction 2d § 4520 (1996) (The statement that *Erie v. Tompkins* "applies only in diversity of citizenship cases . . . simply is wrong.").

The petitioner primarily relies on *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161-63 (1946), and to a lesser extent *Heiser v. Woodruff*, 327 U.S. 726, 732 (1946). Brief of Petitioner at 22-24. Both cases stand for the unremarkable proposition that the *Erie* doctrine does not apply to particular federal interests in bankruptcy. The issue in *Vanston* was the proper treatment of post-bankruptcy interest, which is part and parcel of the federal scheme of distribution. *See* Bankruptcy Code §§ 502(b)(2) (unmatured interest is not allowable on unsecured claims) and 506(b) (post-petition interest is allowable on secured claims). The issue in *Heiser* was whether a claim based on a judgment should be subject to equitable subordination, which is also integral to the federal distributive scheme. *See* Bankruptcy Code § 510(c) (court may subordinate a claim to another claim or class of claims under principles of equitable subordination).

The notion that *Erie* never applies in bankruptcy is overbroad. *See* Alfred Hill, *Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013 (1953) (hereinafter Hill). Hill's article was cited by this Court with approval in *Butner v. United States*, 440 U.S. 48, 52 n.2 (1979), *Agency Holding Corp. v. Malley-Duff & Assoc., Inc.*, 483 U.S. 143, 164 n.2 (1987) (Scalia, J., concurring) (the *Erie* doctrine and the Rules of Decision Act are not limited to diversity cases), and *Commissioner v. Estate of Bosch*, 387 U.S. 456, 477 (1967) (Harlan, J., dissenting) (criticizing strict reliance on *Erie* doctrine as applied in federal estate tax case).

Hill's thesis, in his article written nearly 40 years ago, seems eerily apropos to the heart of the dispute before this Court:

> In [*Vanston* and other] cases the Supreme Court has employed general language to the effect that questions of disallowance and subordination are governed by paramount federal law, in view of the bankruptcy objective of equitable distribution. Taken out of context, the language of these

> cases comes close to suggesting that, in search of independent grounds of disallowance or subordination, the bankruptcy courts may range as widely in the field of equity doctrine as the equity court of a state. If this were so, all transactions underlying claims in bankruptcy would in effect be subject to federal review in the light of an overriding federal commercial law.
>
> It is probably safe to assume that no such result was intended. But the problem remains, and it is relatively unexplored, of the extent to which the equity power of the bankruptcy courts may be employed to defeat state-created rights.

Hill, *supra*, at 1013. The Court has an opportunity today to remedy the problem examined by Hill and, as the conflict in the lower courts indicates, was only partially laid to rest by *Butner*.

IV. A RULE OVERRIDING NONBANKRUPTCY LAW BURDENS OF PROOF HAS ONLY BEEN APPLIED TO TAXING AUTHORITIES. A TRULY "UNIFORM" RULE WOULD BE UNWORKABLE.

The petitioner argues that the "Code's fundamental goal of equality of treatment of creditors is put at risk if one class of creditor . . . is given the benefit of a favorable presumption that is *unavailable to other creditors*." Brief of Petitioner at 27 (emphasis added). To the contrary, however, whenever nonbankruptcy law so provides other creditors *do receive* "favorable presumptions." It is only the taxing authorities that are stripped of their nonbankruptcy rights in the name of "equality." In a variety of nontax circumstances, including claim objection proceedings, courts have had little difficulty ruling that the debtor retains the burden of proof where nonbankruptcy law places the burden of proof on the debtor. *E.g., In re Unioil*, 962 F.2d 988, 994 (10th Cir. 1992) (since party

seeking to prove an accord and satisfaction has the burden of proof under Colorado law, the debtor had the burden of proving an accord and satisfaction in a claim objection proceeding). Many other examples are provided in the margin.[10] While it is *generally* true that claimants –

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[10] *In re Andover Togs, Inc.*, 231 B.R. 521, 530-31 (Bankr. S.D.N.Y. 1999) (in an administrative claim objection proceeding, debtor/tenant had the burden of proving that lease provisions were unenforceable due to equitable estoppel, as required by New York law); *In re Farris*, 194 B.R. 931 (Bankr. E.D. Pa. 1996) (debtor had burden of proving likely Truth in Lending Act violation under nonbankruptcy federal law as any other party raising this defense); *In re El Paso Refining, Inc.*, 192 B.R. 144 (Bankr. W.D. Tex. 1996) (in claim objection proceeding in which debtor was guarantor of debt, court followed nonbankruptcy case law and ruled that debtor had burden of proving that debt between creditor and primary obligor had been satisfied); *In re Brummer*, 147 B.R. 552 (Bankr. D. Mont. 1992) (debtor had burden of proving debt was usurious under Montana law); *In re Biglari Import Export, Inc.*, 130 B.R. 43 (Bankr. W.D. Tex. 1991) (in claim objection proceeding, where creditor had seized collateral prior to petition being filed, debtor had burden of proving that creditor did not exercise reasonable care with regard to repossessed collateral as required by Texas law); *In re Wills*, 126 B.R. 489, 497 (Bankr. E.D. Va. 1991) (summary judgment entered for creditor in claim objection proceeding because debtor had burden of proving by clear and convincing evidence under Virginia law that contractual debt could be avoided on grounds of incapacity); *In re Woehr*, 121 B.R. 743 (N.D. Tex. 1990) (debtor had burden of proving debt usurious under Texas law); *In re Hood*, 95 B.R. 696, 702 (Bankr. W.D Mo. 1989) (debtor had burden under Missouri law of proving that contract was entered into under duress); *The Bible Speaks v. Dovydenas*, 81 B.R. 750, 760 (D. Mass. 1988) (in claim objection proceeding against debtor/church to recover monies obtained on the grounds of undue influence, court applied Massachusetts law which creates presumption of undue influence after a confidential relationship has been established); *In re Borum*, 60 B.R. 516 (Bankr. E.D. Ark. 1986) (debtor had burden of proving usury

as creditors and therefore the functional equivalent of plaintiffs under nonbankruptcy law – usually bear the burden of proof in bankruptcy, as they would outside of bankruptcy, this observation should not form a basis for a so-called *uniform rule*.

> Courts routinely rule . . . that the ultimate burden of proof rests upon the claimant. This is intended to place the claimant in the same position it would have been had the claimant been a plaintiff in a civil action. The application of this rule is problematical when the claimant is a taxing authority.

In re Thinking Machines, 203 B.R. 1, 2 (Bankr. D. Mass. 1996), *modified*, 203 B.R. 426 (D. Mass 1997).

Although less frequent, courts have also dealt with issues regarding *standards* of proof in claim objection proceedings.[11] It would seem axiomatic that *standards* of proof are as much a substantive component of a litigant's claim or defense as are *burdens* of proof. *See, e.g., Anderson*

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under Arkansas law); *see also, In re Niles*, 106 F.3d 1456 (9th Cir. 1997) (state law that places burden of proof on fiduciary to properly account for funds was equally applicable in discharge action); *Thomson v. Boswell*, 166 F.2d 106, 108 (6th Cir. 1948) (in railroad reorganization proceeding, estate was liable in an accident involving a passenger vehicle on the train tracks because Arkansas law required railroad operator to affirmatively prove that it maintained an adequate lookout).

[11] This should be contrasted with *discharge* proceedings, where this Court has held that, as a matter of bankruptcy law, objections to discharge must be shown by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279 (1991). The *Grogan* case illustrates how the petitioner and many courts have confused different aspects of the bankruptcy process. The purely federal issues involve what is dischargeable and how assets are distributed. The purely nonbankruptcy issues generally involve the amount and legality of the debt as of the petition filing date.

v. Liberty Lobby, Inc., 477 U.S. 242 (1986) (because plaintiff was required to prove case by "clear and convincing" evidence, court must consider that evidentiary standard when gauging whether a "genuine issue" of fact existed for summary judgment purposes). Similarly, bankruptcy courts applying nonbankruptcy standards of proof in claim objection proceedings have not perceived a conflict with "bankruptcy policy." *E.g., In re Progress Drilling & Marine*, 122 B.R. 62 (Bankr. S.D. Tex. 1990) (creditor's claim disallowed where Texas law required proof of oral contract by clear and convincing evidence). Other examples are provided in the margin.[12]

The authority cited here indicates that when courts have determined the amount of any debt in a bankruptcy case, pursuant to nonbankruptcy law, they have not generally applied either "uniform" burdens or standards of proof. It would seem that courts have fashioned the supposedly "uniform" bankruptcy rule only when they disapproved of the nonbankruptcy law that would enable a creditor, with statutory priority over other creditors, to prevail. Petitioner argues, in effect, that the taxing authorities' statutory priority dictates the result he seeks to achieve here – that Congress has given the government too much. However, this Court has recently ruled that a

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[12] *In re Cutty's Gurnee, Inc.*, 133 B.R. 934, 945 (Bankr. N.D. Ill. 1991) (adopting Illinois law requiring creditor to show existence of equitable lien by clear and convincing evidence); *In re Bastyr & Assocs., Inc.*, 81 B.R. 978, 982 (Bankr. D. Minn. 1988) (in claim objection proceeding, court applied Minnesota law which requires clear and convincing evidence to show oral modification of contract); *In re Emergency Beacon, Corp.*, 48 B.R. 341, 353 n.5 (Bankr. S.D.N.Y. 1985) (clear and convincing standard of proof under New York law applied in objection to claim based on fraud); *In re Kirk*, 114 B.R. 771, 775 (Bankr. M.D. Fla. 1990) (adopting nonbankruptcy federal tax law requiring IRS to prove fraud by clear and convincing evidence).

court may not use equitable principles to override choices made on a legislative level. *United States v. Noland*, 517 U.S. 535, 539-41 (1996). As the court below so astutely concluded, bankruptcy judges are not permitted to indulge in result-oriented decision making, to "cut down the entitlements that creditors seek to enforce in bankruptcy" and to engage in "[a]n equity free-for-all [which] would engender confusion and uncertainty and increase the strategic incentives to petition for bankruptcy." *In re Stoecker*, 151 F.3d at 551.

V. IF THE OPINION BELOW IS NOT AFFIRMED, THE BANKRUPTCY COURTS COULD BECOME THE STATE AND FEDERAL TAX COURT OF CHOICE. ESTABLISHED POLICY FAVORS NON-INTERFERENCE WITH STATE TAX LAWS AND AVOIDING GIVING DEBTORS A COMPETITIVE TAX ADVANTAGE BY FILING BANKRUPTCY.

Whether to file bankruptcy, and under what chapter, is a generally unilateral decision of the debtor. A debtor does not have to be insolvent to file a bankruptcy petition. *In re Johnson*, 189 B.R. 744, 747 (N.D. Iowa 1995). "But financially strapped or not, a new breed of executives is showing no remorse about wielding bankruptcy as a weapon." Dean Faust, *Chapter 11 Never Looked So Good*, March 20, 2000, BUSINESS WEEK at 44 (discussing the sharp rise in solvent, publicly held corporations filing for Chapter 11). Many courts have held that the bankruptcy code gives a debtor the opportunity to contest a tax obligation, even where all of the deadlines for doing so under nonbankruptcy law have passed. Bankruptcy Code § 505(a); *In re Custom Distribution Serv., Inc.*, 216 B.R. 136, 148 (Bankr. D.N.J. 1997). If the position of the trustee is adopted by the Court, there will be no incentive whatever for taxpayers to exercise their state administrative remedies.

The magnitude of the potential harm to state tax administration is significant. When construing the tax laws, the Court has taken into consideration our "tax system that is so largely dependent on voluntary compliance." *United States v. Generes*, 405 U.S. 93, 104 (1972). The bankruptcy code provides that many taxes are entitled to priority in distribution and are non-dischargeable if they pertain to recent periods, were recently assessed prior to the bankruptcy petition being filed, or were "assessable" after the petition is filed. Bankruptcy Code §§ 507(a)(8)(A) and 523(a).[13] What is intended is that the honest taxpayer who files his returns reflecting a liability will have to deal with the problem, either in bankruptcy or out. If the burden of proof were on the government the incentive to be forthright disappears. There would be no reason to file accurate returns – an audit is scheduled, the records are "lost," and a bankruptcy petition is imminent. The states' audit resources will be wasted.

The states' requirements regarding record keeping and exercising one's administrative remedies could become mere voluntary aspirations. They would often be unenforceable. The provision in the bankruptcy code prohibiting relitigation of tax disputes previously contested in an administrative proceeding, Code § 505(a)(2)(A), would become a fairly hollow protection, because there would be no incentive to utilize such administrative forums. If the decision below is reversed, accountants and tax lawyers could commit malpractice if they do not advise their clients of the benefits of litigating their tax disputes in bankruptcy court. Because bankruptcy courts are bound by the determinations of any administrative tax proceeding, *In re Trans State Outdoor Advertising Co.*,

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[13] Most states' primary revenue source is sales tax, which, if a trust fund tax, is entitled to priority under bankruptcy code § 507(a)(8)(C), and never loses its priority status due to lapse of time.

140 F.3d 618 (5th Cir. 1998), tax professionals would have to be very careful about advising their clients to take advantage of the state forum if the burdens are more favorable in the federal forum. This cannot be what Congress intended. The relationship between bankruptcy code § 505(a)(1) (court may determine tax liability) and § 505(a)(2)(A) (court may not determine tax liability if the tax was contested in a judicial or administrative proceeding prior to bankruptcy), leads to the ordinary conclusion that Congress intended there be no difference in the outcome whether taxes are litigated in or out of bankruptcy.[14]

In fact, section 505(a)(2)(A) (prohibiting relitigation) appears to be an effort by Congress to promote horizontal equity, the notion that the "tax system [is] designed to ensure as far as possible that similarly situated taxpayers pay the same tax." *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 544 (1979) (dicta). "A tax system in which the burden of proof is borne by the government does little to encourage the preservation of records held by the taxpayer; on the contrary, such a system would lend itself to easy concealment of tax obligation." Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 HAST. L. J. 239, 280 (1988) (arguing that political rhetoric regarding shifting the burden of proof is naïve, and that the traditional rule placing the burden on the taxpayer is well-supported historically and logically). "Taxpayers who win the 'hide the ball' game will pay less tax than similar taxpayers who choose not to play." Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Reality of the New Burden-of-Proof Rules*, 84 IOWA L. REV. 413, 456 (1999) (asserting that the

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[14] *One Lot Emerald Cut Stones and One Ring v. U.S.*, 409 U.S. 232 (1972) (no collateral estoppel or res judicata if losing party in first proceeding could possibly prevail by sustaining a lower standard of proof in second proceeding).

strict conditions in the new federal law purporting to shift the burden of proof to the IRS render the burden shift more symbolic than real, and arguing that a genuine burden shift would cause the government to become more intrusive, make audits and tax litigation more expensive for everyone involved, cause a loss of revenue and would create an incentive to "hide the ball" which would be perceived by the public as unfair).[15] The

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[15] The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206 (1998), H.R. 2676, amended the Internal Revenue Code to add § 7491 which purportedly changes the burden of proof from the taxpayer to the IRS in the litigation of federal tax matters. The question for bankruptcy practitioners and courts is whether this change in the burden of proof of tax matters has any impact on the litigation of federal tax questions in bankruptcy. The statute states that it pertains to "any court proceeding" with respect to litigation of any federal income and estate and gift tax matter. I.R.C. § 7491(a)(1). The taxpayer will not be entitled to the benefit of this change unless and until four conditions are satisfied: The taxpayer must 1.) satisfy the requirements presently found in the Internal Revenue Code to substantiate any item, 2.) satisfy the requirements to maintain books and records presently found in the Code, 3.) satisfy the requirements of cooperation, including reasonable assistance in obtaining access to witnesses, documents, etc., and 4.) introduce credible evidence with respect to a factual issue relevant to ascertaining the taxpayer's income tax liability. I.R.C. § 7491(a). If the taxpayer satisfies those four conditions the IRS has the burden of proof with respect to "such issue." I.R.C. § 7491(a)(1). If the decision of the Court in the instant case is reversed, however, it could signal support from this Court to disregard the detailed *preconditions* which a taxpayer must fulfill before obtaining the statutory burden shift, I.R.C. § 7491(a)(2). In fact, what the statute actually requires is that the burden will seldom, if ever, shift in federal bankruptcy/tax litigation, which often involves the paradigmatic lack of records problem. Properly understood, the new statute actually underscores the record keeping requirements and the reasons why the burden of proof was

petitioner seeks a result that will promote this gamesmanship.

If a taxpayer initiates an administrative proceeding and then realizes it is going badly bankruptcy will become a ready escape valve. If an administrative or judicial proceeding under state law is pending prior to the filing of the bankruptcy and different burdens of proof apply in the different forums, it would be foolish for a trustee or debtor to permit the nonbankruptcy proceeding to go forward instead of litigating the matter in bankruptcy court to take advantage of the more favorable burden of proof. It is doubtful that Congress intended the anomalous situation in which the very same claim adjudication proceeding would be subject to different burdens of proof depending upon whether the bankruptcy court abstained from hearing the proceeding and deferred to a state adjudication. *See* 28 U.S.C. § 1334(c).

The tax provisions governing priority and discharge in the bankruptcy code, §§ 503(b)(1), 507(a)(8) and 523(a)(1), were enacted to prevent the bankruptcy courts from being used for tax avoidance.[16] But if the petitioner

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traditionally placed on the taxpayer. *See generally,* Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules,* 84 Iowa L. Rev. 413 (1999).

[16] Since tax authorities are creditors of practically every taxpayer, another important element is that tax collection rules for bankruptcy cases have a direct impact on the integrity of the Federal, State and local tax systems. These tax systems, generally based on voluntary assessment, works [sic] to the extent that the majority of taxpayers think they are fair. This presumption of fairness is an asset which should be protected and not jeopardized by permitting taxpayers to use bankruptcy as a means of improperly avoiding their tax debts. To the extent that debtors in a bankruptcy are freed from paying their tax liabilities, the burden of making up the revenues thus lost must be shifted to other taxpayers.

S. Rep. No. 989, 95th Cong., 2d Sess. 13-14 (1978).

prevails here those statutes will become empty formalisms in many instances. The protection that they provide with regard to distribution and discharge will be insignificant whenever the underlying debt is readily and unfairly eliminated outright. While the greater harm lies in the contest of tax matters between debtors and tax authorities, where debtors would be motivated to withhold or destroy evidence, it is not difficult to envision cases where debtors would solicit trustees' cooperation in denying claims for the debtor's benefit, creating collateral estoppel for a subsequent discharge determination.

In *National Private Truck Council, Inc. v. Oklahoma Tax Commission,* 515 U.S. 582 (1995), the Court noted that federal laws must be construed against "the background presumption that federal law generally will not interfere with administration of state taxes . . . ," and that "Congress and [the Supreme Court] repeatedly have shown an aversion to federal interference with state tax administration." *Id.* at 588. The Court has also stated that 28 U.S.C. § 960 indicates "a Congressional purpose to facilitate – not to obstruct – enforcement of state laws." *California Bd. of Equalization v. Sierra Summit,* 490 U.S. 844, 852-53 (1989). *Sierra Summit* ruled that bankruptcy sales were subject to state sales tax, notwithstanding the lack of specific authority for states to tax those sales. The Court stated that state tax law did not need approval before it applied in bankruptcy court, but to the contrary "[i]f Congress wished to declare otherwise, its intent would have to be 'clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt.' " *Id.* at 854.

The Court's reference to 28 U.S.C. § 960, in its *Sierra Summit* opinion, highlights another congressional bankruptcy tax policy. Section 960 was enacted in 1934 in response to judicial decisions holding that bankruptcy estates were not required to pay state and local taxes and to prevent debtors from obtaining a competitive advantage against those operating businesses outside of bankruptcy. Act of June 18, 1934, ch. 585, 48 Stat. 993 (1934) (former 28 U.S.C. § 124a); H.R. Rep. No. 1138, 73d Cong., 2d Sess. (1934); *Palmer v. Webster and Atlas Nat'l Bank*, 312 U.S. 156, 166 (1941) ("Its obvious purpose was to negative the idea that a federal receiver or trustee could ignore the rules of law of the state of operation affecting the conduct of the business committed to his charge.").

The stated justification supporting the reversal of the burden of proof from that generally recognized in nonbankruptcy tax litigation is the bankruptcy policy of fairness to other creditors. Brief of Petitioner at 27; *In re Wilhem*, 173 B.R. 398 (Bankr. E.D. Wis. 1994) (policy considerations which place the burden of persuasion on the taxpayer are unpersuasive in bankruptcy and the policy goals of the bankruptcy system are put at risk when one class of creditors is given the benefit of a favorable presumption which has its origins outside of bankruptcy law; IRS held to have ultimate burden of persuasion). The policy is inapposite here. The petitioner and many courts have failed to distinguish between the determination of the existence of the obligation, under nonbankruptcy rules, and the determination of distribution to creditors of equal priority, under bankruptcy rules.

The petitioner's conclusion that this Court should federalize the burden of proof rules for all tax litigation in bankruptcy court – and treat the tax authority as if it were a typical creditor when determining the amount of the liability – is unworkable. The National Bankruptcy Review Commission recognized the inequities of placing the burden of proof on the taxing authority when it

adopted a proposal to "clarify that the burden of proof/persuasion rules . . . applicable under nonbankruptcy law are equally applicable in bankruptcy court. . . . " REPORT OF THE NATIONAL BANKRUPTCY REVIEW COMMISSION, Recommendation 3.2.5, at 811 (Oct. 20, 1997).[17]

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[17] The Commission's Report explained the reason why Congress should clarify that the burden of proof should be the same in bankruptcy court as it is in nonbankruptcy tax litigation:

> The Government's position as a tax creditor in a claims contest is different from other creditors in a normal debtor-creditor relationship. It is generally the debtor or the debtor in possession who has access to all of the relevant records, information and knowledge required to substantiate or contest the validity of a tax claim. As such, "[t]he common law rule placing the burden on the party with access to the facts seems particularly applicable in a self-assessment system which provides for the taxpayer to make the initial determination of liability" and bolsters the record-keeping requirement the Internal Revenue Code imposes upon taxpayers. To the extent one creditor is prevented from being able to prove its claim due to lack of information, other creditors benefit to the detriment of that creditor. The Recommendation is designed to protect tax creditors from that result.

Id. at 816 (citations omitted).

CONCLUSION

For all of the foregoing reasons, the opinion of the court below should be affirmed.

Respectfully submitted,

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